CERTIFIED TRANSCRIPT

NATIONAL FEDERAL MILK MARKETING ORDER

PRICING FORMULA HEARING

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

Before the Honorable Channing D. Strother, Judge

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Carmel, Indiana

August 30, 2023

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WEDNESDAY, AUGUST 30, 2023 - - MORNING SESSION

THE COURT: On the record.

MR. MILLER: Good morning, your Honor. I would just like to enter an appearance. I'm Todd Miller, Baker Miller in Washington DC, representing Dairy Farms of America.

THE COURT: Welcome, Mr. Miller. Thank you.

Okay. Where are we?

Ms. Hancock, good morning.

MS. HANCOCK: Good morning. Your Honor, we have producer Ken Nobis here to testify this morning.

THE COURT: Let's welcome him to the stand.

I'll swear you in. Raise your right hand.

KEN NOBIS,

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

THE COURT: Your witness, Ms. Hancock.

MS. HANCOCK: Thank you.

DIRECT EXAMINATION

BY MS. HANCOCK:

Q. Mr. Nobis, would you mind stating and spelling your name for the record?

A. I'm sorry, what?

Q. Could you state your --

A. Oh, state my name. My name is Ken Nobis.

Q. How do you spell that?

A. K-E-N, last name is N-O-B-I-S.

Q. Okay. Are you a dairy farmer?

A. I am a dairy farmer.
Q. And you are here to provide some testimony today for the hearing?
A. Yes.
Q. Did you prepare a written statement?
A. I'm sorry.
Q. Did you prepare a written statement?
A. I did prepare a written statement.
MS. HANCOCK: Your Honor, we have identified his written statement as Exhibit NMPF 61, if we could have an exhibit number for identification purposes.
THE COURT: Let's mark the next one -- my notes indicate we should identify that exhibit as 108.
(Thereafter, Exhibit Number 108 was marked for identification.)
THE COURT: For identification.
BY MS. HANCOCK:
Q. And Mr. Nobis, can you provide your mailing address?
A. My mailing address is 1513 Lowells Road, L-O-W-E-L-L, St. Johns, Michigan, 48879.
Q. Okay. Thank you.
Would you mind sharing with us your written testimony in Exhibit 108?
A. Yes.
Q. Thank you. Proceed.
THE COURT: We're going to have this witness read his statement?

MS. HANCOCK: Yes, your Honor.

THE COURT: Very good.

Sir, you may read your statement. It's maybe -- well, I'll keep this on the record. It appears to be human nature, observed here and other places, that we all tend to speed up as we go along when we're reading something. So in consideration of our reporter so she can get everything down, I'd ask you to be mindful of that, and I'll try to remind you if we speed up. It's not just you.

THE WITNESS: I may need that reminder.

THE COURT: We -- I do myself.

Thank you, sir. You may proceed.

THE WITNESS: Thank you.

Well, I am Ken Nobis. I'm a dairy farmer from St. Johns, Michigan. My farm is located 20 miles north of Michigan's capital, Lansing. And we also are very near the campus of Michigan State University in East Lansing. Our farm is also located 65 miles of east of Grand Rapids, Michigan, and just five miles from St. Johns.

Nobis Dairy Farms is a family partnership that farms 2500 acres and milks 1,000 Holsteins. Since our farm is just 20 miles from the MSU campus and because researchers at MSU work on a lot of projects that they need to apply in a practical application, we have worked extensively with them over the years on their research projects.

I also serve as a College of Ag and Natural

Resources shareholder at MSU, and I am especially proud of the fact of being honored by MSU granting me Honorary Alumnus status in 2019.

I served on the Michigan Milk Producers Board of Directors for 27 years, 12 of those years I was Chairman of the Board. And along with that service, I served on the National Milk Producers Federation Board for 15 years. I held positions of Treasurer and 1st Vice Chair on the National Milk Producers' Board.

I appreciate the opportunity to testify at this Federal Order Hearing, and I support all five of the National Milk Producer Federation proposals. But my testimony is directed more specifically at Proposal 1.

Because many factors have changed since 2000. For one thing, producers deal with a lot more volatility today than they did in the year 2000. On our farm, the volatility in the year 2000, our pay price varied by just $0.52, from a high of $12.95 a hundredweight to a low of $12.43 a hundredweight. In the last 12 months that variance has been $7.46, from a high of 22.50 to a low of 15.04.

Also back in the year 2000, we bought corn to feed our cows for $2.10 per bushel. Soybean meal was purchased back then for around $200 a ton. Today corn will cost you over $5 a bushel and soybean meal is over $500 a ton frequently.

It is important to highlight that producers are compensated for only 9 pounds of protein and other solids

in Class I skim milk sales via Federal Order Number 33 pool. They are compensated for the actual protein and other solids used in all other classes of milk.

Federal Order 33 is a very large Class I market, routinely exceeding 500 million pounds per month. In Federal Order 33 Class I utilization, the utilization ranges from 33% to 41% depending on volume of milk pooled each month. It is time the formula involved in pricing Class I milk reflects the actual value of the milk being produced on our farms today.

The changes made by farmers to produce a better product will continue into the future. Our long research relationship with MSU and seeing firsthand what results could be achieved has been especially gratifying.

I think the first project we cooperated with was the use of prostaglandin to synchronize estrus in heifers, and that was in the mid-1970s. Since then, we have worked with MSU on many things that include various cow comfort adaptations which led to greater component values in butterfat, protein, and other solids.

Cow comfort adaptations started with curtain-sided barns and sand-bedded free stalls in the 1980s. We have been working with Dr. Richard Pursley at MSU for over 25 years as he has been instrumental in developing successful timed breeding protocols. Timed breeding lead to greater efficiency and therefore greater cow comfort which leads to higher milk production and greater component production.

My objective in highlighting some of the research projects is to show how we strive to improve our cow comfort, nutrition, and genetics. This has led to continued -- and will continue to lead to higher milk production and higher component content of the milk supply.

Our milk supply in our farm in the year 200, our production per cow in the year 2000, was 24,930 pounds of milk, 1,024 pounds of butterfat, and 769 pounds of protein.

As of August of this year, 2023, our production is 34,992 pounds of milk, 1357 pounds of butterfat, and 1,054 pounds of protein. Those numbers are going to continue to up. I know Michigan is the leader in production per cow, but production per cow across the nation has grown percentage-wise the same as it has in Michigan, pretty much.

I support the request to have milk pricing formula updated with a mechanism in place to update the formula in the future every three years. Dairy farmers have done their part, having recognized the marketplace’s call for increased protein and other solids and have made decisions to meet the need. I don't think farmers have reached the end of that road, and further improvements can be expected. This formula update will help make certain that producers are properly compensated for meeting consumers’ expectations.

Producers are facing serious cost of production

issues today. I know we are not unique in that respect. But it adds to the reasons why we need to address the issue today and allow for a method to assure that we stay current as component production changes.

Now I would like to go into a little more detail on some of the general things I have mentioned that has led to higher milk production and higher component production.

Greater cow comfort is very significant in leading to these increases. We started probably back in the 1980s with those open-sided barns, and the idea of an open-sided barn is to keep the cows cooler in the summertime.

So they are curtain-sided. So in the summertime, the curtains are up, which adds to greater air flow, keeping the cows cooler. And then that wasn't enough. The next step we took was to add fans to those barns to increase the cooling and the cow comfort issue.

When you put fans in the barn, it keeps the cows cooler on those quiet humid days in the summertime. But then, even if it doesn't get that hot in the daytime, having the fans in place cools that barn much cooler when the sun goes down in the evening.

One other thing, I don't have it in my written presentation here, but I think it's very significant. When we did all that, opened those barns up and put the fans in, one thing we quit using and have never used since is fly spray.

Flies really do bother cows, and they do have an

impact on milk production, and the best fly spray around doesn't keep them off all day. We have to use -- don't use those chemicals anymore, but yet we never see a fly. The only place we use fly spray in our farm today is in the milking parlor, in the milk house.

So when we used to have the heat impact on those cows in July and August, in Michigan, all of the Midwest, that affect -- affected component production and milk production, and you didn't see that returning to normal until at least November, when it got cooler.

So overall, that's really helped add to annual milk production on those cows because they don't have that impact. And there's hardly a farm out there today that doesn't have those measures in place.

One of the other things we have done is on barn design. One thing is -- is higher eave heights today, which allows for more airflow. And another one that doesn't seem that important, but barns today are oriented, at least in the Midwest, on an east-to-west axis, because it takes full effect of the natural air flow.

Another issue is calf raising. We just have so much better calf care today than we did years ago. We understand what they need and don't need.

In fact, it's so good, the survival rates are so good, the growth rates are so good, that we don't need to keep all of our heifer calves anymore. On our own farm we only keep half of them. They are from our best cows. And my best cows, I'm talking about milk production and

component production.

And we select the best bulls, and the best bulls are bulls that will match that production and -- and component production for matings, which allows for an even faster genetic improvement in the herd today. That's why you are seeing some of the -- much greater, faster upticks in milk production, component production than what we used to see.

Feeding dairy cows is a lot more scientific today than it was even in the year 2000. I think most all of us are using professional nutritionists today than we did even in the year 2000.

But just some things you don't think of. The genetics of the food feed supply is different. Corn silage is more digestible than it used to be. The equipment we have today to harvest that, especially alfalfa silage, is so much better than it was in the year 2000.

For example, in the year 2000, we could harvest alfalfa maybe ten to 12 acres per hour. Now it's more like 35 acres per hour, which allows us to get that crop harvested at peak value and decreases the risk of weather damage on that hay. So the base ration is -- excuse me -- is a forage, and the better job you can do with the forage, the better job you are going to do with milk production and component production.

Also, along the way, especially when you are talking about components, there are products we can use

today that really didn't exist or were just coming on the market in the year 2000 to enhance the production of protein and other solids.

Those products aren't always economically viable. In fact, I'm not using all of them on our farm right now because it just doesn't pencil out. And every farm is different. Every farm has a different feed supply. Every farm is managed a little bit differently. For some people, it works; in our particular case, right now, it doesn't work. Although, I have asked my nutritionist to review it again, and he's in the process of doing that today. But the point is the products do exist to help push that issue.

And along the pricing side, the current Class I skim milk value is at 3.1% protein, 5.9% other solids, so the total is 9%. It's been static calculation since the year 2000. Meanwhile, the actual composition of the skim milk produced is 3.39% protein and 6.02% other solids for a total of 9.41%.

An imbalance of pool revenue versus producer value, the 9 versus 9.41, dilutes the value of the producer price differential. This does not promote orderly marketing in the milk.

A PPD based on total actual component value would provide an incentive for me as a producer to supply milk to the Class I market in Grand Rapids, which as I stated earlier is 65 miles away, versus sending all of it to the cheese plant that's five miles away in St. Johns. So it

would help promote a more orderly marketing of -- for Class I market.

But based on historic averages, the protein price at 2.58 a pound and other solids price at $0.21 a pound and a 37% Class I utilization -- and this is averages, this is what we're using here -- the PPD is reduced by $0.29 per hundredweight if the composition factor remains at 9%. So this does not accurately reflect the component value of the milk the producer is putting on the marketplace today.

So I hope I have been able to highlight how dairy farmers have been working diligently through the years to improve the milk production and component makeup of the milk that they produce. Dairy producers are very innovative. They are willing to adopt new technology to keep the business viable and to meet the expectations of the Class I consumer.

But technology is becoming ever more expensive to implement and producers need an economic signal from the marketplace that provides the necessary incentive to continue to be innovative.

And increasing the value of Class I skim milk in the Federal Order pool will provide us some of that incentive. This pricing formula change is necessary to keep farmers in a position to continue to produce milk.

I would like to thank Secretary Vilsack for holding this hearing and providing me the opportunity to testify. And I would be happy to answer any questions

that people might have. Thank you.

BY MS. HANCOCK:

Q. Thank you, Mr. Nobis.

I just had a couple of questions. You said early on in your testimony in Exhibit 108 that -- that you farm and you have the dairy farmer operations; is that right?

A. Yeah. We -- we have a cash crop operation in addition to the dairy operation.

Q. And you talked about some of the additional expenses that -- that you have experienced over the years. I'm wondering if you could talk about, to the extent you are comfortable, the profitability of your dairy farming operation.

A. In the last ten years there's been more than half the time that it was difficult to justify milking cows versus selling cash crops. Last year, 2022 was a good year for the dairy farm; this year has not been so great.

But we just -- we have had this continual good price for the corn and soybeans and wheat that makes it difficult to justify milking cows, to be honest with you. We have been in it for the long run. That's why we have stuck with it.

But by the same token, all across the country, we have lost a heck of a lot of dairy farms, and the primary reason is because they have not been profitable.

Q. And how is it that you have been able to stay in business?

A. I have a partnership. And I manage the dairy, and

my brother manages the cash crops. There's been some very heated discussions about why are we milking cows anymore. But as I said, we have been in the business. We both started -- I came back from the military in '68, so I have been on the farm ever since then. My brother came back in '72, I think.

So there were a lot of years in there where the dairy side of the business kept the cash crop side afloat. It is just that in this -- we have had this switch in the last few years due to a lot of outside factors, global food supply, things like that that have given us -- given the cash crop side of the industry a boost.

And when that cash crop side gets a boost, it's good for the cash crop side, but it's that much worse for the dairy side because we're -- we have to pay for that feed that has a much higher value today than it did in the year 2000.

Q. So is it fair to say that you have to have the diversified operations that you have with both the farming to -- to go hand in hand with your dairy farming operation in order to survive?

A. It's helped us survive with more profits in those lean years, yes. I mean, there's been other dairies that have survived without the cash crop side. It is just that we have been able to do a little bit better by having the diversification.

And it's unfortunate because the dairy investment is extremely high. It is labor intense, and that's what

makes the -- that's why people are leaving the dairy industry today. You need an incentive to milk cows because of the challenges that are involved in the dairy industry with labor, with more management, with everything that you have to do. So it's important that we get the right value for the milk that we produce.

Q. Okay.

MS. HANCOCK: Thank you for your time.

THE WITNESS: Thank you.

THE COURT: Are there questions from other parties? Aside from AMS?

Yes, Mr. Miltner.

MR. MILTNER: Thank you, your Honor.

CROSS-EXAMINATION

BY MR. MILTNER:

Q. Good morning, Mr. Nobis.

A. Good morning.

Q. My name is Ryan Miltner. I represent Select Milk Producers.

I just have a couple of questions on your statement under your pricing bullet points here.

Actually, I have one prior. You talk a lot about the feed costs on the farm --

A. Right.

Q. -- and how that's really impacted margins over the last year.

Are you aware that the Secretary is supposed to take those types of costs into account when setting the

minimum prices?

A. For -- repeat your question?

Q. Sure. Maybe I should rephrase it a little bit, too.

Are you asking the Secretary to take those costs into account when they decide what to do with Proposal 1?

A. Well, there's two issues. I think the primary issue is, is that the producers not -- in the Class I market are not being properly compensated for the milk that we are producing, because we're using that old formula that was accurate in the year 2000, but it's not accurate for the milk that we're producing today.

It is more an issue of fairness in getting out of -- being paid for what we are producing than it is for asking the Secretary to look at feed costs.

Q. Thank you.

On the last page of your statement, you -- you say, "Imbalance of pool revenue versus producer value (9.0 versus 9.41) dilutes the value of the PPD."

That's an interesting concept and a good point. Can you explain for us a little more about what you mean by that statement?

A. For me, it's very simple. I'm not getting full value for what -- excuse me -- for what I'm producing.

Q. And then the next point in your statement, you say that a PPD based on today's actual component values, would provide an incentive for you to supply milk to the Class I plant in Grand Rapids versus I assume Midwest Cheese there

in St. Johns.

A. Right.

Q. Can you explain that a little more for everybody here in the room?

A. The -- the issue is that when my milk hauler leaves our farm, she drives -- actually it is 4.5 miles to Midwest Cheese to unload the milk. So we're going to get -- to haul it to the Class I market in Grand Rapids is an additional 60 miles. It is a transportation issue in that case.

Q. In -- in today's market, I have heard some people suggest that it costs about a dollar a hundredweight to move milk 100 miles.

Does that sound about right to you?

A. I have heard that same number, yes. Yeah.

Q. So for your farm, updating the PPD would be enough of a benefit to incur that additional hauling cost to get to that Class I plant?

A. It would help, put it that way.

Q. I'm curious, before Mid -- well, does your -- does your milk go to Midwest Cheese right now?

A. Yes, it does.

Q. Okay. And Midwest Cheese, that's a relatively new plant, right?

A. Yes.

Q. Do you know or recall where your milk was shipped before Midwest Cheese opened?

A. So Michigan Milk Producers -- I'm a Michigan Milk

Producers member, obviously, we stated that -- has a contract with Midwest Cheese to provide X number of pounds of milk per day. Prior to that, I'm also 16 miles away from Ovid, which is an MMPA processing plant. Our milk went to that Ovid plant prior to Midwest Cheese.

Q. How far is Ovid from your farm?

A. Oh, I think it's about 16 miles, I think.

Q. Okay.

MR. MILTNER: Thank you very much for coming to testify today and for answering my questions. I appreciate it.

THE WITNESS: You're welcome.

THE COURT: Further questions for this witness?

Mr. Rosenbaum.

CROSS-EXAMINATION

BY MR. ROSENBAUM:

Q. Steve Rosenbaum for the International Dairy Foods Association.

I have a question about the data that appears on the bottom of the first page of your testimony, if you could look at that. And I'm looking at specifically the last sentence as to how many pounds of milk you produced, how many pounds of butterfat, and how many pounds of protein.

Now, am I correct that if one wanted to determine what your protein levels were in skim milk, what you would do is take your 34,992 pounds of milk, subtract the 1,357 pounds of butterfat, and then you would divide the

1,054 pounds of protein by that number, namely the pounds of milk minus the pounds of butterfat.

Is that the math?

A. To get the percentages, yes.

Q. Okay. And as I do that math, I have 34,992 minus 1,357 is 33,634 (sic). And so when I divide the 1,054 pounds of protein by your 33,635 pounds of skim, I get 3.13367% protein; is that right?

A. That sounds right.

MR. ROSENBAUM: That's all I have.

THE COURT: Anyone else have questions for this witness?

THE WITNESS: Could I add to that answer?

THE COURT: I'm sorry?

THE WITNESS: Could I add to that question -- answer?

THE COURT: Oh, please.

THE WITNESS: So I didn't -- I think what you are getting at is that our herd does not test as high as the average herd in the United States on -- on protein and other solids, and it doesn't.

And part of that is genetics, but the major issue is, as I explained, we are a diversified farm. We also raise soybeans and wheat and some corn for cash crops. We are not feeding the way most producers do to capture a higher butterfat and higher protein average because we have the cash grain sales.

For example, we harvest corn silage -- we have

1137 acres of corn silage this year -- or corn, excuse me. We will harvest about half of that for roughage for the cows. The other half will be harvested for grain.

In our case, we can make more money, when we look at the whole farm, picture, by selling that excess corn grain in the cash grain market and buying back a commodity, a byproduct, to feed to the cows.

It's a complicated string of numbers you have to put together. But even though we're getting less than what the average producer is because of our protein and butterfat isn't as high, but we have that we're selling -- we're buying back a commodity cheaper than what we could feed the corn that we produce. We're making more money on the corn by selling it and buying back a commodity, even though we don't have as high of solids value in our milk. So there's a reason why we do it that way.

Other producers are not in the same situation. Most of them, obviously. And as I also stated, there are products that we could be including in our ration that would boost both our butterfat and our protein, but it's questionable if it's economically viable at this point in time.

In fact, my nutritionist, who is pretty sharp, we work with Purina, he -- he says it's 50/50 whether it works or not. And we -- we review those numbers, you know, on a yearly basis.

But, again, there's volatility in everything that we deal with today. Methionine, for an example, is a

product you can add that's going to boost those levels. It's not a stably priced product. It is up and down. And if you catch it when it is down, you get it locked in, maybe it would work.

But I don't want to spend -- I have -- that's the reason -- and I'm talking about our particular farm. When I'm sitting up here testifying, I'm talk about the industry as a whole.

MR. ROSENBAUM: Your Honor, if I could just ask a couple of follow-ups on that.

THE COURT: No, of course. I mean, you sat down, but your -- the witness answered after you sat down. So, please. I'm interested.

BY MR. ROSENBAUM:

Q. So are you -- is your milk pooled on a multiple component pricing order?

A. Is it what?

Q. Do you know what the term a multiple component pricing order means? If you don't, you don't. It's a technical term.

A. I'm not sure I understand your question.

Q. Okay. I mean, do you -- all right. Are you -- does -- does the -- does the money you receive, is that -- does that reflect the nonfat solids level in your milk?

A. The money that we receive reflects --

Q. When you receive a -- you know, a check for your milk, is that -- is that -- is that amount affected by --

A. Yes. It's -- it is -- the butterfat, protein, and

other solids are highlighted, yes.

Q. Okay. So -- all right.

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

THE WITNESS: Yes.

THE COURT: Do we have another questioner for this witness other than AMS?

Seeing none, AMS, Ms. Taylor?

CROSS-EXAMINATION

BY MS. TAYLOR:

Q. Good morning.

A. Good morning.

Q. Thank you for being with us today.

A. Thank you.

Q. The Small Business Administration defines a small business for a dairy farm as those making $3.75 million or less in gross revenue a year.

Would your farm be considered a small business under that definition? And this is whole farm revenue, not just from the dairy side.

A. What was the number again?

Q. 3.75 million.

A. 3.75 -- in gross?

Q. Yes.

A. Yes. We would be just over that.

Q. Okay. Thank you.

And does your farm use any risk management tools to hedge in for your milk price or, you know, your feed, whatever? Do you use any risk management tools?

A. I'm sorry?
Q. Do you utilize any futures contracts on the CME or do any type of forward contracting or DRP Dairy, any of those kind of tools to help you manage your risk?
A. Yeah. We do, yes. Not all the time.
Q. Okay.
A. But we do, yes.
Q. Okay. You used to be on the board of MMPA.
Do you have any ideas about how much MMPA milk goes into Class I plants?
A. MMPA itself?
Q. Yeah, the co-op as a whole. And if you don't know, that's fine.
A. I -- I don't have it off the top of my head, so I wouldn't be speaking with true facts.
Q. You indicate your pay price in the last 12 months varied, had a variance of about $7.46.
Is that a gross price or is that a mailbox price that would net out, you know, hauling and other deducts?
A. That would be -- no, it would be gross.
Q. Gross. Okay.
On the last page of your statement, I just wanted to go through some of your bullets just to make sure the record's clear. And I think Mr. Miltner did some of that to help clear it up, but just to be sure.
Your third bullet talks about the imbalance of pool revenue versus producer value and it dilutes the PPD. If I wanted to rephrase that, would I interpret that as

currently handlers of Class I milk gets paid in at the current standard of 9 pounds of solid -- for 9.0 solid standard. But -- and producers are paid on that -- let me gather my thoughts for a second.

Let me just say it this way. If you want to expand on that 9.0, 9.41, are you saying that milk gets paid in at 9.0, but you get paid out on components, which on average are higher than that, so that money gets paid out in the Class III component value to everyone, and there's not that revenue left over to pay out in the PPD. Is that what you mean by imbalance?

A. Basically, yes.

Q. Okay. And so if the PPD was higher, and that imbalance was corrected, in your opinion you would be able to service the Class I market because the higher PPD would cover your addition- -- some of your additional hauling costs to get it to that further-away Class I plant?

A. Right.

Q. Okay. And then on your last bullet you say, based on the historic average of protein price, you have a protein price, other solids price. You say the PPD is reduced by $0.29 per hundredweight.

Can you give us the time period for that historic average you used?

A. I don't remember --

Q. Okay.

A. -- how far back that went.

Q. Okay.

A. Yeah, I -- yeah, I don't -- I don't remember how far.

Q. Okay.

CROSS-EXAMINATION

BY MR. WILSON:

Q. Good morning, Mr. Nobis. Todd Wilson from Dairy Programs.

You answered Mr. Miltner -- or Mr. Rosenbaum a little bit ago about the last paragraph on page 1, talking about your milk per cow, pounds of fat per cow, those numbers there. Are those the same -- if you were to calculate the percentage as Mr. Rosenbaum went through the math there, is that the same percentage that would be applied to your gross price up in the upper portion of where you -- where Ms. Taylor mentioned that there was a variability of $7.46? Is that -- that is at test. That variance is at test. Is that correct, of the $7.46?

A. It's $7.46 at test is the gross value of the milk check.

Q. And that's at your --

A. At --

Q. -- at your component levels?

A. That our -- that was our -- that was -- I was quoting the checks that we received for our milk.

Q. Thank you very much.

A. Okay.

MS. TAYLOR: That's it for AMS. Thank you very much.

THE WITNESS: You're welcome.
THE COURT: Any redirect?
MS. HANCOCK: Thank you, Mr. Nobis, for your testimony today.
Your Honor, we would move to admit Exhibit 108.
THE COURT: Any objection?
Exhibit 108 is entered into this record.
(Thereafter, Exhibit Number 108 was received into evidence.)
THE WITNESS: Thank you.
THE COURT: Mr. Nobis, I appreciate coming out, too, for this.
MS. HANCOCK: Your Honor, at this time we would call Ed Gallagher for our next witness.
THE COURT: Mr. Gallagher, please raise your right hand.

EDWARD GALLAGHER,

Being first duly sworn, was examined and testified as follows:
THE COURT: Your witness, Ms. Hancock.
MS. HANCOCK: Thank you, your Honor.

DIRECT EXAMINATION

BY MS. HANCOCK:
Q. Good morning, Mr. Gallagher.
A. Good morning.
Q. Would you mind stating your name and spelling it for the record?
A. My name is Edward Gallagher, E-D-W-A-R-D,

G-A-L-L-A-G-H-E-R.

Q. And where are you employed?

A. I'm employed by Dairy Farmers of America.

Q. Would you mind providing your business address?

A. I have got two. One is -- I'll use this one. It is my home -- it is my office address. 5001 Brittonfield Parkway, East Syracuse, New York, 13221.

Q. Thank you.

Would you mind providing us with a little information about your background, starting with your education?

A. Sure. Well, first, I was raised on my family's dairy farm in Central New York. I attended Cornell University as an undergrad and received a Bachelor's degree in agricultural economics and farm business management.

After completing my Bachelor's degree, I was hired by the Federal Order Number 2 Market Administrator's Office and worked there for a few years. And was a Wilson scholar. The Market Administrator's Office sent me to graduate school. I went to the Ohio State University and got a Master's of Science degree in agricultural economics.

I completed 12 years of employment with USDA, finishing up with the Market Administrator as its chief of market research, analysis, and information.

In 1996, Dairylea Cooperative hired me to be their economist and to help lead them through the Federal Order

Reform process. During that time at Dairylea, I -- in addition to my duties on Federal Order policy, I took on a number of different management roles within Dairylea, including managing their milk price-forward contracting program.

In 2010, I was hired by Dairy Farmers of America to manage their milk price risk management forward contracting program. My position at Dairy Farmers of America is president of DFA risk management. And I also am responsible now since January 2022 for their Federal Order policy initiatives.

Q. When you say "risk management," what does that mean to you?

A. So we operate -- Dairy Farmers of America operates -- probably the leading dairy farmer forward contracting -- milk price-forward contracting program globally. We offer a number of risk management services who are farmer-owners. They are widely used. We also are -- my team of 19 people also support the dairy risk protection insurance program, or agents that provide that insurance program. We also operate risk management programs for our 83 milk plants and their customers.

Q. Is it fair to say that you operate on both the buy and the sell side of risk management tools?

A. I do. We do, yes.

Q. Okay.

MS. HANCOCK: Your Honor, at this time, I would offer Mr. Gallagher to be qualified as an expert in

agricultural economics, Federal Milk Marketing Orders, and risk management.

THE COURT: I find him so qualified.

MS. HANCOCK: Thank you.

THE WITNESS: Thank you.

BY MS. HANCOCK:

Q. Mr. Gallagher, did you prepare a written statement in anticipation of your testimony here at this hearing?

A. Yes.

Q. And is that what's been identified as Exhibit NMPF-4?

A. Yes.

MS. HANCOCK: Your Honor, I would ask to have NMPF-4 identified as Exhibit 109.

THE COURT: Yes, so identified.

(Thereafter, Exhibit Number 109 was marked for identification.)

MS. HANCOCK: Thank you.

BY MS. HANCOCK:

Q. And then, Mr. Gallagher, did you also provide a brochure from Dairy Farmers of America that's been identified as Exhibit NMPF-4A?

A. Yes.

MS. HANCOCK: Your Honor, we would ask to identify NMPF-4A as Exhibit 110.

THE COURT: Yes, so marked for identification.

(Thereafter, Exhibit Number 110 was marked for identification.)

MS. HANCOCK: Thank you.

BY MS. HANCOCK:

Q. Mr. Gallagher, would you mind providing us with your testimony today.

A. Yes, thank you.

What I would like to do is provide a summary and use my statement, which I'm projecting on the screen, to show some of the charts that I want to explain a little bit further, and hopefully we can get through this a little bit quicker.

So specifically today, I'm here to talk about our proposal -- the National Milk Producers Federation Proposal Number 1, to update the factors in the skim milk price formulas under the Federal Orders, to update them to the current producer price -- or excuse me -- the producer component test in Federal Orders.

Simply put, what we are doing is asking USDA to re-establish the skim milk minimum price, skim milk formulas to the same policy initiative that they implemented under Federal Order Reform, to provide a more accurate skim milk price formula for more accurate skim milk prices, for minimum prices, across all Federal Orders, for Class I, Class II, Class III, and Class IV.

I'm here to testify about the impact of this on risk management programs in the dairy industry.

So changing the skim milk factors will change the pricing formulas, and changing the pricing formulas will have an impact on risk management transactions that were

entered into prior to the knowledge of what the change will be and the timing of when the change will be implemented.

Failure to recognize that change and delay the change, we're asking for a 12-month delay in its implementation, will create financial harm to dairy farmers, milk plants, end users, and others who entered into risk management transactions prior to the knowledge of the change and the timing of it.

We -- we realize that we need to update the skim milk factors. There has been ample evidence that has been provided in prior witness testimony, undisputed evidence, that the component tests and the producer supply that increase significantly since the year 2000 -- well, the late 1990s when the factors were determined that were implemented on January 1, 2000.

We recognize the need for this change, but we also recognize the impact that it will have on risk management transactions, and because of that, we're asking for the 12-month delay, to let those transactions or most of those transactions roll off before those skim milk price formulas actually are effective.

So what the big concern is, from the producer hedging side, is that we, with our proposal, updating the skim milk components is going to update what I call the standard milk test for announcing class prices.

So currently, that standard milk test will be -- is 3.5% butterfat, 2.9915% true protein, and something

like 5.6985% on the solids. When we -- when we make this change, we are going to be changing that standard component level, and they are going to be higher.

And the problem in risk management, especially for dairy farmers who have made these transactions, is that they rely on the component basis as an informed value in making their risk management decision. When we make this change, that component basis, a lot of it, sometimes all of it, will be consumed in the class price and won't be available for dairy farmers anymore as part of their risk management transactions.

We work with a lot of DFA farmer-owners on their risk management strategies. Our focus working with them is to help -- to try to help them lock into a profit margin. And oftentimes, when we are doing these transactions, they talk to us about a profit margin that they can lock in, their gross milk price all in, all components, PPD, the whole nine yards, less what they believe their costs of production are. A lot of times they will lock prices in when they know they can get a 1 or $2 per hundredweight profit margin.

As an example, in the fall of 2019, we worked with a lot of our farmer-owners to manage their milk price risk for the first half and the second half of 2020. And they were telling us they were locking in profit margins of around $2 per hundredweight. Not all of them, but that was a common theme.

When COVID hit and prices crashed, and the milk

prices fell to intolerably low levels, the dairy farmers, farmer-owners that used our programs on the milk they forward-contracted were able to earn a profit in cash flow on that transaction.

Now, I say $2. I'm going to run through my statement once through some examples on the farmer's side assuming a Class III hedge.

And so there's a term that's important, and the term in risk management is called basis. Simply put, the basis is what a farmer gets paid in their milk check in this case, a dairy farmer gets paid in their milk check, minus the hedge that they are transacting.

So on a Class III forward contract, their basis would be the PPD, and also it would be the additional components above the standard. As we have seen, undisputed in the record, that the component levels -- the component levels on dairy farmer-produced milk are now -- it's not unusual to see dairy farmers produce Holstein -- Holsteins produce 4% butterfat and about 3.25% protein.

And so that difference from the current standard that the Class III price is now pretty significant. In fact, for 2020, 2021, and 2022, I bet that component standard for a lot of dairies was about $2 per hundredweight.

And so what's that risk that we're talking about is that basis that they rely on that is what they look at as their profit margin when they enter into these transactions will be partly eroded and consumed in the

milk price and not available for them anymore.

And that gets explained later on in my testimony on pages 11 through 16 about how component basis is cannibalized.

And on page 3, at the top of page 3, there's a chart that is the U.S. All-Milk Price, and you can see it changes tremendously. This is the primary price that influences the revenue for dairy farm families across the United States. This is a key statistic that shows what dairy farmers across the United States receive in their revenue.

Most of us get a salary, and you know, we have had -- we have seen over the last 36 months quite a bit of volatility in our lives with inflation and other things going on, but our salaries didn't go down because of some economic event.

In the dairy industry, for dairy farmers, their salaries go up and down every month, and it's tremendously volatile, as you can see from that chart, which is why dairy farmers need to implement and think about and be consistent users of risk management strategies to better protect their fairy farms.

In addition to the programs that we use to help dairy farmers lock into a profit margin, we find significant use of a program through the Federal Crop Insurance Program called Dairy Revenue Protection Insurance Program, which effectively puts a floor on milk prices, and they get all the upside. Pretty good deal.

So a lot of times, if our farmer-owners aren't using a forward contract to lock in their milk price, they will use the Dairy Revenue Protection Program -- Insurance Program, put a floor on their milk price, to prevent further price erosion from happening. So there are a lot of important tools that are available in the dairy industry.

By the time this proceeding gets to a final decision and is implemented, all of those transactions will be settling against the announced class price, at whatever the standard component test is at that time. And so all of those transactions will be impacted by the change in the component levels if we don't delay it.

Another area that I discuss as a challenge that would be for the consumer side, the plant side, is the impact on cross hedges, and that discussion in my statement is on pages 16 through 19.

What a cross hedge is, is that you try to build into a -- say, a Class IV price by using the components of butter, or butterfat, and nonfat dry milk for nonfat solids. And we use this quite a bit at DFA.

So for -- we have a target blend program that's very popular with our farmer-owners to help them lock into their milk price. Oftentimes, we will use the CME Group futures products to hedge our risk, the risk that DFA takes on to offer a fixed price to one of our farmer-owners. We back everything so that we can be assured if a dairy farmer wants a price, we cover it with

some sort of hedge transaction, so that we are assured and they are assured that we can honor that price, and we're protected. And the dairy farmers that -- of owners of our -- of DFA that aren't using these risk management programs don't take on any risk.

So oftentimes, what we will do is there will be -- we'll have some transactions on the plant side. For instance, we're one of the largest ice cream manufacturers in the United States, and so we'll lock into an ice cream price for one of our customers. When we do that, we are generally going long on a butter futures contract, because the ice cream manu- -- the ice cream buyer doesn't want something to happen later on that increases the price of butterfat and will raise their ice cream price if they just buy it as it comes. And so we have opportunities for them to lock in their butterfat price, or lock in their ice cream price.

We also export dairy products around the world. And there's oftentimes that we have an export buyer from another country buying our powder that wants a fixed price, and so we will use financial derivatives to lock in that price. Same situation, they don't -- they don't want their price to go up. They are willing and accepting that if prices go down, they will give up the lower price. They don't want their price to go up.

And so we go long, and when you go long in the futures market, if the price goes up, the futures contract is profitable, which then creates revenue for DFA to cover

the higher input cost that maybe we're buying from our farmers to make the product, and it allows us to give them a fixed price.

Well, a lot of times we'll do those two transactions in the futures market, but not always, because with our blend price program, which is a short position, so farmers don't want their milk price to go down, so they sell in the futures market, and if the price goes down, that financial transaction, that derivative is profitable and covers that loss of income.

So we have got -- we have got a sell side with our farmers and a buy side with a couple customers, and so what we do is sometimes we match them up without going to the futures market.

The challenge that we have right now is that because we don't know what this change will be or when it's going to be implemented, we aren't going to be utilizing those internal transactions to make that hedge because we won't be able to come equal on both sides, and we'll have a loss in the middle. And that is explained in -- on pages 16 and 19.

Ms. Krema testified from the CME on Monday and did an extraordinary job providing insights into U.S. dairy derivatives markets, and I think her testimony was very credible.

And the top of page 5, I provide a chart very similar to what Ms. Krema showed in her testimony. The difference between my chart and her chart is that hers was

average daily open interest and mine is open interest on the last trading day of each one of those years.

And I'd like to use this chart just to highlight something a little bit more. The last time we were together, or some of us were involved, in a national hearing to consider class price formula changes, was back in 2007, 2008. And when you look at this chart, you can see the number of transactions on the CME Futures Dairy Complex, which would be whatever their futures contracts were at the time, had been growing, but is significantly less than what it is now. In fact, now it's three to four times the level.

So the last time we got together to discuss class price issues at a national Federal Order hearing, the use and -- and understanding of these derivative transactions was not as significant nor was as significant of an issue back at that time. Far different than it is now.

In fact, I recall in that time period, I was a Dairylea employee, helping to work with the Dairy Farmers of America risk management program. And I was asked to join the DFA salespeople and other account managers when they met with some of our customers, during 2008, 2009, 2010. And they would have a topic list of things that the customer wanted to talk about, and frequently the number one topic at those meetings was how they could use the DFA risk management program, forward contracting programs, to help their -- protect them against milk price volatility.

Now I don't go to those meetings so much, and the

difference is a lot of the buy side has invested in people who are very sharp at using these derivative programs and understood their use. And so that is part of the reason why we have seen such a significant increase in the use of these programs.

On the sell side, when I started at Dairy Farmers of America in 2010, we had an astonishingly low volume of milk covered under our forward contracting program. I totally changed our approach on how we interact with a farmer-owner. In fact, we were outsourcing it in some cases. The education effort, we were outsourcing to others. The silliest thing I had ever heard of.

I stopped that, day one stopped that, and I hired people that could work with dairy farmers, explain risk management to dairy farmers, and take what was happening in the derivative market and relate it back to their milk checks so they could understand it. And the use in our forward contracting program skyrocketed, which is part of the reason that you see the significant increase over time.

Others -- others in the industry, that would be brokers that worked extensively with dairy farmers, also did a lot better job of explaining how to use these programs to dairy farmers.

And so the use is significant and is of -- and is now something that is so intertwined with the Federal Order program because every one of these types of futures contracts settle to an announced price by USDA that has

backstopped with an important price in the Federal Order pricing system.

Ms. Krema did a better job than I did, as we go to the top of page 6, in showing open interest information. This is a snapshot of two particular days this year, the open interest of futures and options on the CME Group Dairy Complex. It is May 26th and August 8th.

And what I'd like to point out is just sort of the role on how these futures contracts demand the amount of open interest changes over time. So you can see that on May 26th, we hadn't settled the May class -- the May Federal Order prices yet, so those contracts were still treading. They still had open interest.

You can see 12 months out, you get to May 2024, and you can see fairly significant open interest through May 2024, and then it falls off fairly considerably. In fact, the second half of 2024 at that point had very little open interest.

You move to August where both May and June prices have been announced, and those futures derivatives on the CME had rolled off the board and new ones have come on. And you can see the significant change in open interest, and you can see it extends out well beyond the 12 months.

And Ms. Krema's data that she showed in her testimony, I think, was much better than this in showing sort of the seasonality and the change.

I talked about the Federal Crop Insurance Program. On page 7, middle of the page, is a chart. What that

chart is, that's data from the Risk Management Agency that I have summarized, and it shows the coverage by crop year. Now, a crop year runs from July 1st to June 30th, and a crop year -- so we look at -- let's take 2022. The crop year of 2022 doesn't mean all those transactions settled out in that crop year. It's just the insurance policy was taken out sometime between July 1 of 2021 and June 30th of 2022. That's the 2022 crop year.

It shows significant use. When you average those numbers, because we don't know exactly what the coverage would be for any one annual time period, any one January through December, when you average those out, it's pretty close to about 53 billion pounds of milk has been prior -- at least up until 2023 crop year. That's about 23% of the U.S. dairy supply.

In the DFA risk management programs, the volume of milk that's covered by our farmer-owners and forward contracting is about the same as the volume of milk that's covered under our Dairy Revenue Protection Insurance Programs. They are both pretty significant. They have both grown. In fact, in 2022, we had record volumes in both programs.

And so sort of interpolating a little bit that the -- relative to our use, and interpolating what I think that means for producer coverage using the CME Group futures derivatives for dairy farmers, that I think somewhere between -- in 2022 -- somewhere between 35 and 45% of the U.S. milk supply was hedged by dairy farmers

across the United States. So it is pretty significant. It's pretty significant.

I mentioned that we use risk management to support exports. I'm going now to the middle of page 10. So we are very fortunate in the United States to have such a robust and well used dairy risk management program. The CME Group futures market is by far and away the leading dairy risk management futures market anywhere.

And it creates a significant strategic benefit to the United States versus who we would say would be our competitors in international marketplaces. In Europe, there's a futures market, the EEX. And for New Zealand they have a futures market that they can use for dairy; it is the SGX. Neither of them have grown very much. They are getting more and more use.

But if you look at this chart, the open interest when you take their contracts, which are smaller sized than the U.S. contracts, you convert them to their U.S. equivalents, and you add up then their U.S. equivalent of contracts that they would have, again, on the last day of trading, for 2022, their open interest was about 20,000 contracts, which is about where the U.S. dairy industry was in the early 2000s. So we have a significant advantage over our European competitors when it comes to the export markets to be able to strategically use these programs to support the growth in U.S. dairy exports.

Okay. On page 11 is where I start my discussion of the impact to dairy farmers and the need to delay

12 months. And so simply put, this chart goes through the transaction and the determination of the Class III milk price, using factors that I have -- use as an example. And my example is that 2021 average component prices, announced by USDA, the average cross amounts for 2021, the annual average, the butterfat price, the protein price, and the other solids.

And it goes through what the component factors are to determine the Class III price: 3.5% butterfat, 3.1 other protein, and 5.9 other solids. It's the 3.1 and the 5.9 which we are seeking to modernize and update to meet the average component test in producer supply.

As you go through that, and you come out with a 17.08 Class III price. I'm going to use that -- I use that 17.08 Class III price in my example of what all this means to dairy farmers.

Now, when I go through this example, I'm going to -- I'm going to use an example where -- I'm going to page 13, the middle of the page. I'm going to use an example where I'm using different protein and other solids component tests, and I'm not changing the butterfat price. Right?

So in this example, on this dairy, that dairy probably actually had a 4.0 butterfat test, but if I use that 4.0 in what I'm trying to show to show you the impact of what would happen when we change these factors, it will cloud it by adding in butterfat component basis that we aren't concerned about because we aren't changing the

butterfat standard. So I leave butterfat as 3.5 for convenience to show the change.

And so this particular chart, though, looks to be -- what's the full component test? So the change hasn't occurred yet. This is an example of a dairy farm who produces 3.5% butterfat, 3.27 protein, and 5.81 other solids, and so their full component Class III price is $17.90.

The Class III price that they would hedge at would be 17.08, which means they have a component basis of $0.82. It's that $0.82 that ends up at risk of being cannibalized as we raise the component factors in the skim milk test. It is that $0.82 I talk about as part of that basis, that when we say dairy farmers lock in a 1 to $2 profit, the $0.82 is part of that. The rest of the 1 to $2 is on the butterfat side, but we aren't changing anything in this proposal that's going to impact the butterfat, so I'm leaving that out.

Going to the bottom of page 19, so this converts to the butterfat, protein, and other solids factors -- or excuse me, not the butterfat -- it converts the protein and other solids factors to our proposal. And it goes through and it recalculates what the announced Class III price would be.

Now, I specifically -- going back to this chart -- I specifically chose these component tests when I converted them to a skim milk value -- would be the same as these -- to help show my point.

So now we go through, you realize the brilliant testimony that the National Milk Producers Federation has provided, and you choose to adopt our proposal. Thank you. We appreciate that. But we're changing what the announced Class III price would be. It's now going to be 17.90 instead of 17.08.

Going to page 15, middle of the page, this chart. So here's sort of what the dairy farmer was thinking about. All right. So the dairy farmer did this transaction months before they knew what the change was going to be or when it was going to be implemented, but as it turns out, this -- this hedge they did settles after the change happens.

So that dairy farmer had an expectation of locking in a Class III price of 17.08, knowing that they then had a component basis in addition to that of about $0.82, they said for $17.90, I can make a profit on my dairy farm, and so I'm going to lock it in.

Now we go to the change, after the fact, and the announced Class III price is $17.90. But there's no additional component basis, it's been absorbed into the Class III price.

So the dairy farmer then, the transaction is they hedged at 17.08. They didn't want the price to go down. Nothing else changed that -- the component prices were the same when they hedged as when they settled the price. The only thing that changed was the factor in the formula.

And so the formula then said the settlement price

that would be used by the CME and by our forward contracting programs would be 17.90. So they hedged at 17.08 to protect themselves from the price going down, but the price went up, so they had a loss on that hedge. They had a loss of $0.82 a hundredweight.

So they ended up at the price that they wanted in the futures market that they saw, they are ending up at 17.08, but what's missing is they don't any longer have that component basis because when they sold their milk to whoever they were -- they were selling it to, they got paid the 17.90. They got paid their full components. They got the 17.90. But there was no additional value in that basis than what they were -- as they were expecting when they made the transaction.

And that's where the challenge, that's what the problem is, why we are asking to delay this for 12 months.

I'll stop there, Nicole. The last part, pages 16 through 19, go through sort of the cross hedge transaction, but I'll stop there and be happy to entertain questions. Thank you.

Q. Thank you, Mr. Gallagher.

One question on the last part that you were just mentioning on this delayed implementation. If we're at this hearing today, and it's going to take us some time before any kind of anticipated change that could happen will actually be effective, I'm wondering if you could talk about when that 12-month period or why that 12-month commencement of the delayed implementation would occur at

the -- at the final order or the implementation of any change as opposed to why people couldn't build that into their risk management tools starting today so that we could have the advantage of this kind of foreshadowing?

A. Correct. Thank you. That's an excellent question.

So unfortunately, uncertainty is uncertainty, and so not knowing when this is going to happen is then becoming a guessing game. And what our risk management programs are meant to do is to take uncertainty away and make it more certain.

And so, you know, we have some view in our mind when we think this final decision may be announced, and so for transactions that would be occurring after that date, we have quite a bit of uncertainty on how we use these programs to support effective risk management for both our dairy farmer-owners, our milk plants, and our customers.

Did I get to where you wanted to go?

Q. Yeah. I mean, I think is another part of this as well, that they can't afford to not continue to engage in their risk management tools because it's so integrated into their current business practices?

A. Yes. So if I may sort of answer -- add to that answer.

So, Mr. Nobis mentioned that he used risk management sometimes. And so if Mr. Nobis was a DFA farmer-owner, I would pull him aside after I'm done here and explain to him the need to be consistently using the

programs because you never know.

We found, and unfortunately, a year -- so last year, the end of 2022, there were some pretty decent prices that dairy farmers could cover for the first half of this year. But those prices that were offered didn't offer a profit margin, so they didn't cover. We begged them. Some covered, but not as many as usual. And unexpectedly, prices fell off the charts, as we know. It happened in the spring and into the summer.

What the challenge is, is that we probably will see less risk management coverage because of the uncertainty that we're going to be facing. And you never know when prices are just going to fall off the shelf and decline rapidly like they did last -- this -- this past spring and into the summer. And so that is going to -- that uncertainty will bring a lot of challenges to financial -- the financial operations of a lot of dairy farmers.

Q. And then in Exhibit 110 that you have in front of you, that's the Dairy Farmer of America brochure, if you look at the second page there, can you talk about the map that's reflected there?

A. Yes. So the dots represent one of our DFA farmer-owner farms. So you can see where we're located. We have seven operating councils. Each operating council, you can see there sort of their geographic boundaries by the light blue outline on the gray scale map. And our operating councils -- or each operating council for that

region is responsible for marketing the milk of our farmer-owners, getting paid, and determining pay prices, and writing the milk checks for our farmer-owners in those areas.

Q. Okay.

MS. HANCOCK: Thank you, Mr. Gallagher.

Your Honor, we would submit the witness for cross now.

THE COURT: Questions for this witness, other than AMS first?

CROSS-EXAMINATION

BY DR. CRYAN:

Q. I'm Roger Cryan with the American Farm Bureau Federation.

A. Hello, Roger. How are you?

Q. Very well. How are you today?

A. I'm good. Thank you. You?

Q. I think I said so. I think I said I'm very well. Thanks.

Okay. I'm -- I have been impressed with the way you have grown DFA's market -- risk management programs over the years. It really feels like it is part of DFA's recommitment lately to serve the members in the industry and the community, and I -- I -- I'm -- I thought this was a good reflection of that.

A. Thank you.

Q. Now, you talked about 2020, and some of the volatility, some of the crazy things that happened that

year. You've talked about prices dropping off the table.

And if I understand your programs correctly, and you haven't -- I don't think you quite brought this up -- but when there was some real chaos in terms of basis risk and with respect to uniform prices versus Class III and IV prices, for example, in 2020, your -- a lot of your programs covered -- covered producers, right? A lot of your producers who were using your forward contracting program as set forth saw a lot of that risk managed; is that right?

A. That's correct. And we paid out between -- on our forward contracting programs, we paid out tens of millions of dollars to our farmer-owners during that period. And those that would have had the Dairy Revenue Protection Insurance Program, although we don't write those checks, that comes from RFA --

Q. Sure.

A. -- they also got tens of millions of dollars. So a very effective risk management implementation during that time period --

Q. Yeah, you --

A. -- that was beneficial to our farmer-owners.

Q. Very good.

And you -- and your program, because you are serving the farmers as producers, trying to help them manage risk, and not just selling some product, you dovetailed all the different options they have, like the USDA programs, the various USDA programs and risk

management, and the crop insurance and dairy margin coverage, and then you fill the gaps with --

A. Yeah.

Q. -- futures and options and so forth; is that right?

(Court Reporter clarification.)

BY DR. CRYAN:

Q. And then you fill the gap with futures and options and other forward contracting tools; is that right?

A. Yes, that's correct. So I didn't spend time talking about the Dairy Margin Coverage Program. That's widely known, I believe --

Q. Yes, it is.

A. -- and is by far and away the single best risk management program in the dairy industry. And so when we work with our farmer-owners, we start and look at how much they have -- they can get covered under the Dairy Margin Coverage Program, and so that's -- that's covered.

Q. Okay.

A. And then we work on whatever delta they have in their milk production with our other programs.

Q. So putting those all together gets kind of complicated. And in 2020, when -- when basis blew up and there was massive amounts of depooling, a lot of the programs, a lot of the proposals from National Milk are aimed at -- including this one -- are at least in part aimed at addressing class price misalignments and negative PPDs and depooling, trying to -- trying to address that.

Could you talk about some of the impacts that negative PPDs and depooling had on DFA as a -- as a -- as a company, as a co-op that was taking on a lot of risk for its members, and on the members themselves?

A. Yeah. So we're a little bit different than others in the marketplace because we offer blend price-forward contracts, and we offer producer price differential forward contracts.

And so when those negative basis hit, dairy farmers that had a blend price-forward contract were protected, and those that -- so if you think a little bit about, you know, you -- if you buy corn, right, you buy corn, you can buy off the board, you can buy the basis, or you can buy it delivered.

So think of our blend price-forward contract as the delivered price. And then we have other dairy -- other farmer-owners that will say, I just want the board price, which will be covering Class III. And then there will be others saying, I just want the basis, which would be the PPD. So we have -- we can cover all three of those options for our farmer-owners. So a little bit different.

A lot of our transactions on risk management were protected against that basis change, but not all of them. And so because of some of the anomalies that happened in dramatic differences between class prices that resulted from various actions during COVID, the -- those farmer-owners that didn't cover that PPD basis in one way or another had very negative impacts on what they were

expecting for the outcome of their hedge.

Not because of component basis changes necessarily, but because when they were making their transaction, they weren't expecting to have a minus -- I'm making this up a little bit, but it's in the ballpark -- a minus $8 PPD. They were either expecting a zero or maybe slightly higher. And so when you lock in to a $20 milk price, and you think you're going to get a PPD of zero, and that $20 milk price is pretty good, then that's fine. But when you lock into a $20 milk price and you end up with an unexpected minus $8 PPD, you are really netting $12, and that is not a financially viable transaction, unfortunately.

And so some of -- you know, the five proposals that National Milk is offering up would support stronger PPDs and would lead to more effective risk management transactions by dairy farmers across the industry.

Q. Yeah. Larger and -- and more consistent, right? Less variability in the PPD, that's -- those are kind of two of the aims that will help support your -- your support for producer risk management.

A. We would like stronger and more consistent PPDs. I don't have analysis to know if our proposal is going to do that or not --

Q. Okay. Very good.

A. -- consistently.

Q. Thank you, Ed. Thanks very much.

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

THE COURT: Anyone else?

Mr. English.

MR. ENGLISH: Your Honor, I actually think this would be a good time for a break.

THE COURT: The hearing reporter thinks so too. I think so too.

And I'm beginning to wonder whether ten minutes is enough. Enough? Okay.

The hearing reporter says it's enough. Let's come back at 9:50.

(Whereupon, a break was taken.)

THE COURT: On the record.

Mr. English, your witness.

MR. ENGLISH: Thank you, your Honor.

CROSS-EXAMINATION

BY MR. ENGLISH:

Q. Good morning, Mr. Gallagher. My name is Chip English. I think we have known each other since probably 1987 or something like that.

A. I think so, yeah. Good morning.

Q. And in this proceeding, I represent the Milk Innovation Group.

A. Very good.

Q. So I -- I realize your testimony is about Issue 1, but I think it is important to understand the philosophy behind the testimony. So I want to ask sort of a holistic question about the whole proceeding.

Is it your position that USDA should postpone

implementation of whatever changes it makes from this proceeding all at one time?

A. Clarify that.

Q. Okay. So let's say, contrary to our position -- because we're not in favor of Issue 1 -- if the Secretary were to adopt your Proposal 1, which you seek to have 12 months delay, should the Secretary similarly delay implementation of any decisions on Issues 2, 3, 4, and 5?

A. The only implementation delay we are asking for is for the implementation delay on the component changes to the minimum class skim milk prices.

Q. So you are not going to appear later or someone on National Milk's behalf is not going to appear later to request that, say, for instance, Issue 2, survey changes, would be implemented later?

A. What are Issue 2 --

Q. That's the survey. That's like removing barrels from -- from the survey, adding 640-pound blocks, adding mozzarella, things like that. I mean, I basically -- I think -- I think if I'm correct, because this would be a really short cross-examination -- if what you are saying is that National Milk is only asking to delay implementation of Issue 1 and not any of the other proposals, is that what you are saying?

A. Yes.

Q. Well, then let me suggest, to the extent it is helpful and the extent -- obviously USDA's not bound by anything. But nonetheless, there is a concept called

negotiated rulemaking. Let me suggest to you since we oppose Issue 1, your proposal, and you are in favor of Issue 1 and seek that it be implemented 12-month delay, we are entirely in agreement.

MR. ENGLISH: And I think my cross-examination is over.

THE WITNESS: Thank you Mr. English.

CROSS-EXAMINATION

BY MR. MILTNER:

Q. Good morning, Mr. Gallagher.

A. Good morning. How are you?

Q. I'm well. Thank you. Ryan Miltner, and I'm representing Select Milk Producers.

When you talk about DFA's risk management programs available to its members, what does that all entail? What are the different programs that you offer?

A. Quite extensive. So we -- we pride ourselves on being able to create forward contracting programs to cover price risk of any dairy product.

So, for instance, to get into the weeds a bit, the -- if we have a farmer-owner who wants to solely cover the Class III price risk in their blend price, but feels that maybe the whey price is so low that it could only go up, so they don't really want to lock the whey price in, we have a method to help them just cover the protein price and protect the protein price and let the whey price change.

We also offer, through our forward contracting

programs, opportunities for our farmer-owners to hedge feed price risk, and we build that into the milk price that they would receive through a milk price-forward contract.

So we have got -- on the producer side, on the farmer-owner side, a significant number of options, and we have ways that they can lock the price in. We have opportunities for them to get a floor where they get all the upside. We have transactions that we call min/max forward contracts where they lock in the floor or they get a floor price, but instead of getting all the upside, they only get some of the upside, but in -- in -- in -- in recognition of that, they get paid a certain value for that transaction, or it reduces -- it reduces the cost of the floor to limit the upside.

We have other programs where if they're locked in, we have something that we have created that we call the upside rider. So an upside rider, if you were locked in at say a $20 Class III price, and you were okay with -- with prices going higher, but if they really went higher, if they went to $28, you would really feel bad, you would want to get some of that, the upside rider that allows us to do a transaction with the forward contract and adjust that price. So let's say for a particular fee, that when the Class III price exceeded $23, that they would get the value above $23, and they would only be locked in up to that $23.

So we have got quite a variety of programs. We

used to show it -- interestingly -- we -- when -- when we sort of -- we are constantly learning how to do a better job to talk to our farmer-owners and simplify our whole process. One of the things we used to do, we were too proud of ourselves, we used to show a chart, an extensive chart, that had about 40 lines on it, that were most of our risk management transactions. And we found that when we showed that in our -- in our intro to risk management, it was so overwhelming that it turned our farmer-owners off. So we don't show that anymore, and we just sort of -- but we have -- we have lots of options and lots of variety. And we can extend all of that, also, over to our own plants, and we can extend it to our customers, depending on what their needs are.

Q. Are the underpinnings of all of those different programs ultimately CME derivatives?

A. Absolutely. So I -- I did reference that we can do internal transactions. I referenced that when I was presenting my statement. But most of the hedges that we do are transactions with a CME futures product.

Q. Tell me about the -- you mentioned an internal hedge. What is that, and how does that work?

A. Sure. So a -- we would have a dairy farmer, farmer-owner, that wants to cover the class -- as an example -- Class IV price risk in their blend price. They don't want the price to go down, so they are going to -- we're going to -- so we do a forward contract with them for that Class IV piece. We go into the futures --

normally we would go into the futures market and we would sell a Class IV futures.

Sometimes, instead of doing that, we are able to, at the same time, know that we have a customer who we are selling ice cream to who wants to lock in their ice cream price, who then would have -- we would make a transaction, normally in the futures market, to buy a butter futures.

And at the same time maybe we have an export transaction for nonfat dry milk powder where we are selling to our customer overseas at a fixed price, and normally, what we would do to support that fixed price is that we would buy a nonfat dry milk futures price.

Instead of going into the futures markets for producer farmer-owner transaction and the two pieces of the transactions with our customers, we just meet in the middle and we do it internally without going to the futures market.

That's what I -- that would be the internal transaction. And in my testimony, I talk about the middleman. DFA would be the middleman in that transaction.

Does that make sense?

Q. It does, thank you.

On those types of internal transactions, what exposure is there to the cooperative, and therefore its owner members, if -- if a Proposal 1 is not delayed 12 months?

A. Yeah. We -- we -- as the middleman we won't get

back to -- so as it stands now, we can sort of perfectly match up everything, so that as the middleman we don't take on any risk of profit -- I mean, profit -- we don't take on risk of loss. But as this occurs, we do. And we will -- we will -- there will be an amount we -- we will be uncertain whether we can get back, not knowing what the change is, when it changes, the implementation date. So that creates an exposure to us that we can't manage.

Q. And DFA, like all cooperatives, it's owned by its farmer members, correct?

A. DFA is owned by I think it is 11,000 -- we have 11,000 farmer-owners, operating about 6,000 family farms.

Q. So would it be correct that in addition to the impacts on your members with respect to the transactions you describe in your testimony, exposure that DFA may have through internal transactions, or otherwise, that's farmer exposure too, isn't it?

A. Yes.

Q. Okay. Thank you.

MR. MILTNER: I don't have anything further, your Honor.

THE COURT: Anyone else other than AMS?

CROSS-EXAMINATION

BY MR. COVINGTON:

Q. Calvin Covington, Southeast Milk, Incorporated, I'm representing.

Good morning, Mr. Gallagher.

A. Good morning. How are you?

Q. Just fine. Thank you.

I want to ask a few questions and focus on the earlier part of your testimony.

But first thing I want to ask you, though, is, over the last couple of years, have you been a part of the National Milk Producers Federation group of representatives from the various dairy cooperatives to develop this proposal, Proposal 1, that you are talking about?

A. Yes.

Q. Okay. And what is the purpose of National Milk's Proposal Number 1?

A. So -- so our purpose is to -- to re-establish the accuracy of determining minimum skim milk prices across all Federal Orders, for Classes I, II, III, and IV, by returning to the policy initiative that they implemented during Federal Order Reform, meaning that the skim factors to determine minimum skim milk prices be based on the average producer component tests across Federal Orders.

Q. All right. And why -- why is that update needed?

A. As we have -- as has been shown in testimony, I think, by everybody that has presented evidence on component tests, that these component tests have increased substantially and that we no longer have the accurate determination of those minimum skim milk prices across all Federal Orders.

Q. Okay. Now, in your testimony, and the response here, we keep using the term skim milk components, which

Proposal 1 is about.

What are the purpose of those skim milk component factors?

A. Those skim milk component factors are used to take the product derived protein, nonfat solids, other solids, and convert them to skim milk prices.

Q. Okay. And why does the Federal Order system need those skim milk prices, that conversion?

A. Skim milk prices are reflective of the -- it's important that the skim milk prices are reflective of the general component tests across the industry, and that when establishing Class I prices, Class I price is the Class I mover plus a differential at the minimum Class I price.

And in Federal Order Reform, the initiative, the policy initiative, is that the Class I mover was meant to reflect average manufacturing prices. And right now, it doesn't, because in all of the component orders, the average manufacturing prices, really what the components are in the order, which are significantly higher than they were in 2000, and so the skim values are out of date. And we don't see the connection -- Mr. Nobis very ably explained its impact on his dairy, that -- that we don't see the connection with the Class I price, that minimum Class I skim milk mover being priced off of manufacturing price anymore.

Q. Okay. So the skim milk prices per hundredweight, as you just responded there to the earlier question, that are calculated from the component prices, they are needed

to help establish the Class I mover skim and also the published Class II, III, and IV skim milk value prices?

A. Yes.

Q. Okay. All right. When the Federal Order Reform was implemented back in 2000 that you referred to several times, did those published Class III and Class IV skim milk prices per hundredweight approximate the actual Class III and IV skim milk prices at test at that time?

A. Yes.

Q. Okay. All right. And then, again, as you just testified and also as you have responded, where component prices have increased, do the current published Class II, III, and IV skim milk values and also the Class I mover skim milk value, do they approximate the current component levels at the time?

A. Could I ask you to ask the question again? Because I think you said component prices instead of component tests.

Q. And I very, very well could have been, so I -- I appreciate that.

Do the current -- does the current Class I mover skim value per hundredweight, Class II, III, and IV skim milk values per hundredweight, do they approximate -- published prices, do they approximate the actual prices at test of the current II, III, and IV skim milk prices?

A. In the Federal Orders that have multiple component pricing, Class II, III, and IV values approximate. The Class I values do not. When you look at what the skim

milk -- minimum skim milk prices would be, they do not approximate in any order what the actual producer tests are right now.

Q. Thank you.

When the current skim milk components were implemented back in 2000, as a part of Federal Order Reform, were they ever intended to designate the minimum skim milk component levels in Class I Federal Order skim milk?

A. No, they were not.

Q. Okay. And if the National Milk Producer Proposal Number 1 is implemented, does that mean that the Class I skim milk must meet the proposed update -- updated skim milk component levels?

A. No.

Q. Okay. And has been testified, the National Milk Producer Proposal 1 would increase the Class I skim milk price.

Does that increase give any kind of economic advantage to one fluid handler over another in the Federal Order system?

A. So the change would result in the average -- or excuse me -- the Class I skim milk price mover being higher, but being the same in every single Federal Order. So there would be no competitive -- inter-competitive advantage or disadvantage for any of the regulated handlers.

Q. Okay. And currently under Federal Order

revisions, Class I handlers, to meet their obligation to the Federal Order system when it comes to the skim milk, they account for that skim milk on a per hundredweight basis; is that correct?

A. Yes.

Q. Does National Milk Producers Federation Proposal 1, does it change that?

A. No.

Q. Okay. Thank you, Mr. Gallagher.

MR. COVINGTON: Your Honor, that's all my questions.

THE WITNESS: You're welcome.

THE COURT: Next, Mr. Rosenbaum.

CROSS-EXAMINATION

BY MR. ROSENBAUM:

Q. Steve Rosenbaum for the International Dairy Foods Association.

You have provided your views as to the purpose of various undertakings during Federal Order Reform in 2000.

Can you point to any specific statement in the decision by USDA when they implemented those reforms as to whether there would be a need for any future revision in the skim milk composition assumptions, one way or the other?

A. I don't have anything to point to from the record.

Q. Okay. And --

A. That I am aware of.

Q. And were you aware that at the time that Federal

Order Reform was instituted in 2000, USDA had issued previously decisions where they made the explicit statement that with respect to Class I, there was no value in additional nonfat milk solid components?

A. I would answer your question first by directly responding, I'm not aware of that.

But I would answer -- also follow up, in that the same -- when they -- when they implemented the Federal Order Reform decision, they struck it at the average component test that existed at that time.

Q. Did they actually say that's what they were doing in a decision, as opposed to simply trying to come up with a formula that roughly approximated the current pricing under the MW series?

A. I don't have specific information to add to that.

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

THE COURT: Anything further from anyone?

Yes.

CROSS-EXAMINATION

BY DR. VITALIANO:

Q. Peter Vitaliano, National Milk Producers Federation.

Mr. Gallagher, I would like to just follow up on the question from Mr. Rosenbaum just now with regard to whether the Federal Order Reform decision contained anything that anticipated further adjustments in the future.

Is it your understanding that in terms

specifically of the component composition factors in the Class III and Class IV formulas, the skim milk formulas, that at that time of Federal Order Reform around 2000, the average composition of producer milk was pretty stable and not changing very much, and therefore would not necessarily be something that they would comment on in the Federal Order Reform decision?

A. Mr. Vitaliano, I would say that it was fairly stable. I don't know -- I can't -- I can't get into the mind of USDA at that time and the relative merits of commenting or not commenting.

But I think if you -- if you look at the testimony, the evidence that has been submitted at this hearing, you will see a change in the component tests that have been pretty significant, beginning around 2010, that have increased substantially. And it is not -- as you had mentioned in your question -- it is -- it is not sort of just a little change or consistent component tests. They are significant.

Certainly Mr. Nobis's testimony referenced why. The testimony from Dr. Van Amburgh at Cornell University testified why. And so there's just been significant component production growth across the U.S. milk supply, and it is my expectation and belief it is going to continue.

Q. That is the very reason for Proposal 1. But my question specifically was the situation around the time of Federal Order Reform.

DR. VITALIANO: Thank you. No more questions.

THE COURT: Anyone else?

AMS, your witness.

CROSS-EXAMINATION

BY MS. TAYLOR:

Q. Good morning.

A. Good morning. How are you today?

Q. Well, Ed, I'll be honest, risk management is something I have not had to learn for my entire career in detail, so this is good way to start a Wednesday.

A. Well, hey, welcome to my world.

Q. So bear with me a little bit.

A. Yep. I understand completely.

Q. I do appreciate you coming here to testify today on this subject. So thank you very much.

A. You're welcome.

Q. I think I heard from an answer you gave to someone else's question that DFA has 11,000 farmer-owners and 6,000 dairy farms.

Did I hear that correctly?

A. Yes.

Q. Okay. And what percentage of those farms use risk management tools?

A. So can we count Dairy Margin Coverage?

Q. Yeah, any risk management tool.

A. I would say close to 100%.

Q. And then since you're talking about the impacts to the CME, and that doesn't necessarily deal with DMC, what

would you give an estimate on without DMC?

A. I -- I believe it's over 20% of our farmer-owner farms.

Q. Okay. And do you know about how much production then is covered?

A. I do, but I don't want to -- because of the information I have put in this testimony, and some others, our -- our -- others in the industry will be able to back into some of the types of coverages that we sort of feel is proprietary.

Q. I certainly can understand that. Thank you.

I don't know if you can speak to for DFA as a whole -- and I have asked the same question of other witnesses -- about their members meeting the small business definition of $3.75 million in gross revenue. Do you know about how many of your farms or farmer-owners meet that definition?

A. We recognized that you would ask that question.

We don't have the access to our farmer-owners financials, so we -- we don't know for sure. But we've done some estimations based on what we think based on each farmer-owner's annual milk production, and backing into a size -- an estimated size of farm, because we don't necessarily know the number of milk cows that they have, either. But recognizing that it is around a 700-cow dairy, we think that about 80% of our farmer-owner farms would meet the small business definition.

Q. Great. Thank you. I appreciate the

back-of-the-envelope calculations.

Another question. Have you seen in recent years, especially as we went through COVID and getting out of that, an increase in the use of risk management tools from your members?

A. Yes, we have. So for calendar year 2020, we saw record use of our program -- programs, and for calendar 2022, we saw record use of our programs. And I would say, I believe I'm right, I don't have my statistics in front of me, but in 2022 that record volume was almost double the prior record volume. So significant uptick in risk management.

And when you -- Ms. Taylor, when you think about the growth that's going to occur in the U.S. milk supply, there will be growth in all sizes of farms, but as the math works, most of the growth is going to occur on dairies in excess of 700 farms -- 700 cows, just that's the math. Right?

And so as the growth occurs -- so -- so -- on those dairies, if you are -- any -- any dairy, any size dairy has debt. When you get to these larger farmer operations, they have millions of dollars of debt and a slim profit margin, and they will be -- I'll be talking more about that when we get into the Class III and IV issues -- well, what profit margins look like on dairy farms.

And so it is a necessity for most of these dairies, especially the larger dairies, to utilize risk

management transactions because they cannot afford a long-term low price that is below their cost of production, and there are many, many opportunities to use these derivative markets to protect against that. And as the dairy industry's milk production grows, there's going to be a greater concentration of that growth on these larger sized dairies taking on greater amounts of debt and needing to use these programs even more, later than they do now.

Q. So you expect that to accelerate?

A. Yes, I do.

Q. Okay. In your testimony, you refer to the term -- to "run-off." And I know -- I think that term was used last week, and I'm pretty sure it's an industry term. So if you would like to just explain for the record what that means. I think I know what it means, but I'll let you explain.

A. That's a technical economic term in risk management. Run-off, it means that -- so as an example, we typically have a farmer-owner that will forward contract their milk today for the next 12 months. And so when I refer to a run-off, that means when -- so they have their forward contract for September 2023 through August 2024. And so when I mean a run-off, is one month settles out. So the September forward contract settles, technically, in October. Then whatever result of that forward contract occurs, gets into that farmer-owner's October milk check, and so we had one month of run-off.

So that's what I meant by run-off.

Q. Thank you.

A. You're welcome.

Q. On page 7 of your testimony, towards the bottom, this is under the Federal Crop Insurance for Milk section.

Oh, first on the chart, I wanted to make sure I got this correct. For your crop years from July 1st to June 30th, does that mean 2019, for example, is July 2018 to June 2019?

A. Yes. So we're currently in the 2024 crop year. So the 2024 crop year started on July 1, 2023.

Q. Okay. Thank you.

And those numbers coverage, billion pounds of milk, I think you said, this is when the coverage was taken out, not when the contract ends.

Did I hear that correctly?

A. You did hear that correctly.

Q. Okay. And then in the text at the bottom, you try to explain why the coverage -- the numbers show a decrease in 2023, for two reasons. And the first one you state, "First, Class III and IV price levels offered were considered" -- "were down considerably, but production costs were at or near record high levels making the hedge less interesting."

Can you expand on what you mean there?

A. Sure. Our focus with our farmer-owners is to help them manage to a profit margin. And so we we're not -- we're not milk brokers.

Q. You are not milk, I'm sorry, what?

A. We're -- we're not a -- we're not a brokerage firm. We don't have -- a dairy farmer-owner doesn't have an individualized account with us. We are doing -- we are changing the price of the physical product. So -- and we focus on profit margins and how we can help them bring -- we can bring value to them on their operation to try to create a more consistent profit or protect against price erosion.

So we aren't ever talking to them about which direction we think the market is going and to try to get them to make a bet on direction. And so when I say it's less interesting, it means when we present them with a perspective of what the futures market would show would be the milk prices, and we have got a proprietary process of taking whatever the futures market presents itself at any one moment, and bringing that back in and presenting to our farmer-owners what that would look like in their milk check each month, going forward many months.

And so it was not interesting because when we -- we took that futures market information, put it into our formula and showed them what the milk price -- milk check milk price on their dairy would look like in the future, they looked at it and they said, I can't lock in a profit. And unfortunately, they also said, and because of that, we think the price has to go up.

So the less interesting part was they couldn't lock in a profit, and so they didn't do as many

transactions as we would have hoped they would have normally done.

Q. And -- and is it fair to say they couldn't lock in a profit because of the feed costs were -- let me see what you used here -- production costs were near record high levels?

A. That is very fair. And when I -- I will eventually return, make a return appearance to talk about topics with the Class III and IV proposals, I will be presenting information on cost inflation on dairy farms across the United States, that will show specifically what that challenge would be.

Q. Okay. Bear with me. This was my late night reading, so I have to remember what all my little notes mean.

A. You stayed awake. I'm impressed.

Q. Okay. I'll get to that question later.

On page 9, at the top, you say, "I would estimate the use of CME Group futures and options by dairy farmers was equivalent to about 20 to 25 billion pounds."

That's not just DFA numbers, correct, that's just industrywide?

A. That is my estimate of industrywide, correct.

Q. Okay. And so the use of CME plus the Revenue Protection Insurance Program.

And are you talking DRP and LGM Dairy combined into that number?

A. Sure.

Q. Yeah.
A. The LGM Dairy is so small, it's a rounding error. But, yes.
Q. Okay. But not --
A. Even though it's a good program.
Q. I heard last week it's going to increase, so --
A. Yeah. I'm sure the guy that owns it has got to promote it.
Q. On page 10, in this chart, it is the -- you have stuff from -- I think that's New Zealand and the European futures markets?
A. Correct.
Q. Okay. And you convert -- I just want to make sure I'm clear. You took their contracts, numbers, and the volumes, and you converted that over to show the CME equivalent contracts.

And CME contract volumes are what again?
A. So for Class III and Class IV, that's 200,000 pounds of milk; for butter and cheese, is 20,000 pounds; for whey and nonfat dry milk powder, it's 44,000 pounds.
Q. What was that for whey?
A. 44,000.

And Ms. Krema is listening, and she will text me pretty quick if I got any of that wrong.
Q. Well, good, because I'm going to quote her here shortly for you. She can text me -- or I don't have her number -- she can text you if I'm wrong.

Okay. I was curious. On page 12, you are talking about DRP, and I recognize -- well, I know you all use this program, so I -- I -- you talked a little bit about changes that are in -- in -- being considered right now to that program. And I think as I read it, the change would be that DRP would settle against the formula -- the change would be -- the DRP contract would settle against the formula at the time of settlement, not at the time of entering into the contract. That's the proposed change.

Do I understand that right?

A. That's correct. Did Dr. Bozic describe that when he testified?

Q. I don't think in quite the detail, or maybe I just didn't pick up on it at the time.

A. Okay.

Q. But you're up here, so I'm going to use this opportunity to ask a few questions about it. He did say there was a change that would be for the next year upcoming.

A. Yes.

Q. But if I remember correctly what he said was, that change would solve the upcoming year's issue, but it wouldn't solve the year after that. It was like a temporary fix. And -- and I might be getting that wrong. I would have to go back and read the record.

But when I read what you wrote here, right, so that's the change they're proposing, it struck me as then why doesn't that change solve the DRP problem when it

comes to the implementation -- it might not solve your CME issue, but why doesn't that solve the DRP issue?

A. The -- the -- what I'm expecting the change to be.

Q. Yeah. Uh-huh.

A. So presently, the Dairy Revenue Protection insurance settlement price is based on whatever the formula that existed in Federal Orders at the time you took the transaction out. It -- it is my understanding that I -- I -- is that sometime in the future, that it's going to be changed to whatever the formula is at the time of the settlement price, which puts it on the same footing as how the CME transactions are settled. So it -- it follows through -- the same issues exist that I described for dairy farmers that would use those tools and the consumption of the component basis would be the same for the Dairy Revenue Protection Insurance transactions as well after that change is made.

Q. Okay. On the bottom of 12, going onto 13, the sentence reads: "Basis is the difference between the price that is being hedged and the price, based on the hedge, that the producer expects to receive. For dairy producers, the producer price differential would be part of their basis when hedging the Class III price."

I just wondered if you could explain that a little bit more for me.

A. Sure. So if you think about Todd's statistical price announcement when they announced the PPD, there is a section where they show what the statistical uniform price

is, and that section is the Class III price at standard test plus the PPD equals the statistical uniform price. And so when we have a -- when we have farmer-owners trying to hedge their milk check, milk price, which is more like their blend price, and they may be using a Class III hedge, then that basis would be the difference between statistical uniform price and the Class III price, and some of that basis then becomes the PPD.

Did that sort of resonate okay? Did that make sense?

Q. Yeah. I'm just going back to look at your other charts.

A. And so -- so just clarifying, when I went through my example in my statement, I assumed there was no PPD.

Q. Okay. Thank you. That was the first time you mentioned it, so that's why I was asking.

A. Yep.

Q. Okay. So the PPD would be in the -- so, for example, on page 13, if we could go to that chart.

A. Yes.

Q. So they are locking in -- they are taking the hedge out at 17.08; is that correct?

A. That is correct.

Q. But they expect to receive --

A. 17.90.

Q. -- 17.90?

A. Yes.

Q. But that doesn't include any of the PPD?

A. Correct. So --
Q. They would expect to receive in reality --
A. Maybe --
Q. -- 17.90 plus some PPD?
A. PPD plus the butterfat component.
Q. Right. Okay.
A. That's -- I didn't include as well.
Q. Okay. Okay. Thank you. That's helpful.
A. You're welcome.
Q. Let me move to my questions on my computer instead of on my sticky notes.

I know you weren't here last week. Did you listen to Ms. Krema's testimony?

A. I -- I listened to it driving to the airport.
Q. Okay.
A. I got some of it.
Q. I'm sure you can still answer these questions, but I do want to just --

MS. TAYLOR: Your Honor, can I bring up Exhibit 78 to him? Because I do want to refer to a table in there.

THE COURT: Yes.

MS. TAYLOR: And this is the testimony that Ms. Krema entered into the record last week.

THE WITNESS: Thank you.

BY MS. TAYLOR:

Q. First is just a general question. My second question, we'll get into a piece of that.

So the CME witness who testified last week

mentioned the over-the-counter market, and I don't see that mentioned at all in your testimony.

So I was just curious about DFA's use or your members' use of the over-the-counter markets?

A. Yes. So I can't comment on our members' use of the over-the-counter market. We -- we sometimes -- so when we execute our hedges, our main coverage will be in the CME futures, and then there's some other areas that we can also cover. We may have a direct forward contract with a customer. We may have some internal. Or we may use the over-the-counter market.

I was trying to get some statistics on the coverage, the use of the over-the-counter market, and I didn't get what I needed in time, so I didn't include it.

I believe in Ms. Krema's testimony she indicated that most -- so to give an example of an over-the-counter hedge, so -- which is also known as a swap. So a bank may be the intermediary on that swap. So I'll -- I'll use energy. It is not part of milk, but it is no different.

We may hedge the natural gas input price at our milk plants, and instead of going to a -- directly to a futures market ourselves, we'll go to a swap partner. That may be a bank. And I'm not sure what the bank does to manage their risk, but they may likely go to the futures market themselves, because they can bundle all these other entities that are doing the same hedge and -- and get better coverage.

So that same type of transaction happens in the

dairy industry, and it could happen for Class III, cheese, or nonfat dry milk, where somebody's going to an entity, doing a swap, and that entity then is covering -- generally covering their risk, and a lot of times it goes back to the CME.

So even though there are these OTC transactions, I don't -- I don't have a way of knowing how that builds beyond what I'm already suggesting is coverage that would -- that would be coverage. Right? It just may be another means of covering that transaction.

You did make a specific question. We have -- from time to time, we will have a swap with a dairy farmer to cover their feed. But we don't do a lot of swaps with our farmer-owners. We handle most of everything through a forward contract.

Q. Okay. So following up on that then. From what I gather then, you don't see the OTC market kind of as a useful transition tool during this implementation time possibly?

A. It is a useful tool. They would suffer from the same challenges as we would going to the futures market.

Q. Okay. I do want to refer in the Exhibit 78 we handed you, to page 4, Figure 3, which is at the bottom.

So last week -- or this was Monday. Already seems like last week. As Ms. Krema explained when she testified on Monday, this chart shows the average open interest distribution from 2018 to 2022. And so when I look at this chart, and I'll read, say, the second line of data, I

read that as saying, on any given day, 75% of the open interest contracts on the CME will close within six months.

Would you say that's an accurate reading of that line?

A. So I didn't produce the chart.

Q. Right.

A. It sounds accurate.

Q. Okay.

A. Okay.

Q. So if you just assume for --

A. Yes.

Q. -- this discussion it's accurate, I guess what our question is, and I know Proposal 1 is asking for a 12-month implementation, but what would the impact be if USDA, if we -- the Secretary decided to implement Proposal 1, and chose a different implementation schedule than NMPF has offered, given that this open interest shows that, you know, a vast majority of contracts are only about six months out on any given day?

A. Yeah. We -- we advocate for the 12-month delay, and without -- and I don't think it's appropriate for me to comment on something less than that, especially not knowing what that something less would be and not knowing what the amount of time would be from the date you announce the final decision until the implementation of everything else. Because I'm assuming that's not going to be within 30 days, but maybe it would be. So there's

there's other variables I'd have to take into consideration to be able to more appropriately reply to that question.

Q. Okay. And along that line, when USDA issues a final decision, at that point is when we go out for a producer vote. And then assuming the vote is a yes vote, we then issue a final rule, which gives the implementation timeline.

You wouldn't consider the time period after the final decision as proper notice to the industry of kind of the changes USDA would be recommending as adopted?

A. We may. And I -- instead of -- we may. It's a reasonable question. Again, I guess it would -- it would -- would be important to know how many months that would be. So I get what you are saying.

And as an example, so the record's more clear with what I'm saying. So, for instance -- I'm making this up -- that you said on -- make it easy for everybody -- that you said that the -- that the final decision came out on January 1, and you were going to implement it on June -- July 1, and the implementation of the component factors was the following January 1. That's about 12 months. We -- well, that would support I think the 12-month delay.

Q. Okay.

A. And if not, somebody else from the team will be up here and correct me later.

Q. If they don't ask you a question when I'm

finished.

A. But we support a 12-month delay in implementation.

Q. Okay. But the start of that 12 months could possibly be the final decision point, not necessarily the final rule point?

A. Yeah.

But on one other thing to consider, it has yet to be determined the outcome of the Milk Innovation Group's complaint and the National All-Jersey group complaint, and there could be a delay in your implementation time because of something. And it may not be that, it could be something else.

Q. Uh-huh.

A. And so -- so that can really change that dynamic of do we actually have that lead time and then shorter implementation time after that. That's a hard thing to know. Right?

Q. Yes. Okay. Thank you.

A. You're welcome.

Q. And in response from a question that Mr. English asked you, you said that NMPF is only seeking an implementation delay for Proposal 1.

Ad I'm curious why -- if you can explain why you don't see any similar risk management issues if other factors that are being considered in this proceeding are also changed.

A. So I do. But when we weigh balance of everything, for the other proposals, we weigh what the changes are,

the needs for the industry to change, make those changes, and then the risk management impacts, as we weigh those balances at the National Milk Producers Federation, we come to the conclusion that for the other proposals, they need to be implemented immediately, because of the impact to the -- to the entire dairy industry, weighing everything.

And we're sort of in a -- we're sort of -- National Milk Producers Federation is sort of in a unique position when we look at what's best for the U.S. dairy industry. Right?

The National Milk member cooperatives represent about 75% of the milk produced in the United States. They write milk checks to the farmer-owners of -- you know, the National Milk Producers Federation member cooperatives write the milk checks to their farmer-owners, and we have got a governance structure. Every one of us, every National Milk member cooperative has a governance structure that allows for easy access and communication from farmer-owners, up through the management, to the boards of directors. It is an amazing, amazing process.

We also operate every kind of milk plant you can think of. We are leaders in Class I processing. We're leaders in Class II processing, III, and IV. And so we are in this really unique position to be able to weigh all these things together and how it impacts every aspect of the dairy industry.

And when we do that, we come to the conclusion

that the need for some of these adjustments outweigh the potential negative impacts on some of the risk management transactions, and that's why we are not in support of a delay for changes for National Milk's other four proposals.

Q. And so in that case, if any of those proposals were recommended by the Secretary and eventually implemented, in those instances, producers would lose that basis of those --

A. Well, now you ask. So from a dairy farmer perspective, if they hedged in advance of the Make Allowances increase which results in the class prices going down, they have protected themselves against that decline, and the impact on their component basis from whatever that change would be is not very much. So if they have actually hedged, they will -- they will get the price they were expecting for the most part. And for a lot of the other proposals that we have, ultimately improves the PPD, so their basis improves.

Q. Okay. So it's the Proposal 1 scenario where their basis would decline.

A. Correct.

Q. Okay. Thank you.

A. You're welcome.

Q. Let's see here. Proposal 1 seeks to have the changes implemented in March. Curious if it makes any difference, assuming -- let's just assume Proposal 1's adopted, and under that assumption there's a 12-month

delay, but maybe it doesn't work out to be March.

Is there a different consequence if the changes happen in the spring versus the fall, for example?

A. No. Not to my knowledge. If there is, we'll brief or --

Q. You'll come correct it later.

A. Someone will correct me. We got lots of opportunities to correct whatever I'm saying here.

Q. We will be here for a while.

So the time of year isn't -- doesn't necessarily matter; it is just the 12-month piece that matters?

A. Yeah. So a little bit on how we -- how Peter constructed that. He did a nice job. Mr. Vitaliano is Peter. For the National Milk Producers Federation. We knew that -- we think that by early March we would know the component tests for the previous year, and so it -- we didn't think it would take very long to make a computation on what the averages were, and then we would want to notice the industry as soon as we can. So that's how we came up with that. But if there's a better construct for you, we would be open to that.

Q. Okay. My apologies. I try to --

A. You're quite all right. Take your time.

Q. -- go in logical order, and I didn't -- I missed one technical question. This should be my last question.

On page 16, and that's where you start to get into your discussions of the cross hedging. But you did have a statement in here that says, "We are concerned that some

of the liquidity providers will permanently exit the CME Group futures and options market."

I'm wondering if you could just expand on that statement, on that concern and its implications.

A. Yeah, I want to show -- I want to show a chart, so bear with me.

Q. Uh-huh.

A. Okay. This is the chart I was looking for.

So in addition to the milk brokerage companies that work directly with dairy farms -- this is on page 5 of my testimony, statement.

In addition to that -- and the efforts of DFA and others to educate, one of the things that also has occurred over time is the brokers have hired individuals to trade in our futures markets to support more transactions. And so, for instance, maybe we had a dairy farmer that wanted to cover their milk 18 months out for one month, but there was no buy side opportunity in the general commercial business place.

So the brokers would hire people to potentially, for that brokerage, take the other side of that position, or maybe it would be what would be a full commission merchant, which would be the entity that housed all the trades for a group of brokers and worked directly with the CME.

So they started investing more in those people around the 2008, 2009, 2010, 2011, 2012. And so then -- so they would be considered liquidity providers because

they aren't necessarily hedging, they are supporting the growth in transactions.

Also, what has happened is there is -- you would potentially maybe have heard of hedge funds that transact in corn markets or soybean markets. Well, there are entities, I don't know who they are, entities that might be like a hedge fund, that have decided to come in and do transactions in some of our dairy markets, that also would be considered -- they aren't necessarily hedging a commercial transaction in the dairy industry. It may be part of something that they are doing to protect the business from inflation or whatever. And so they would be considered liquidity providers.

Those individuals -- and I have -- those individuals are -- are from time to time nervous because there's participants like me who know more about what might be happening in futures markets than maybe they do, and that they then would be concerned that they may -- may not -- they may not be in an equal footing in knowing what may happen to markets, so they can be kind of skittish.

And so if all of a sudden there are these significant changes to -- consistent changes, more frequent changes, to the pricing formulas, they may find that their knowledge of these is not strong enough to know how to manage their transactions to protect themselves from losing money, and they may take their investment money out of the Dairy Complex and use it somewhere else in another commodity or somewhere else instead of -- and

that's what Anne was referring to, is sort of those individuals that are sort of making their own -- risking their own capital and providing more transactions, that liquidity, but they will leave the markets.

And if they do, or they reduce their activity, that probably would result in -- I don't know if it will result in reduced open interest or slower growth, but it would have a negative impact.

Q. Okay. Thank you.

A. You're welcome.

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

THE COURT: Anyone else have a claim of re-cross?

Seeing none, redirect.

MS. HANCOCK: Thank you, Mr. Gallagher, for your time today.

Your Honor, we would move to admit Exhibits 109 and 110 into evidence.

THE COURT: Any objections?

Exhibits 109 and 110 are admitted into the record.

(Thereafter, Exhibit Numbers 109 and 110 were received into evidence.)

MS. HANCOCK: Thank you.

THE WITNESS: Thank you.

THE COURT: You are excused, Mr. Gallagher. Thank you for being here.

Mr. English, you have arisen from your chair.

MR. ENGLISH: Chip English for the Milk Innovation

Group.

We have been doing a really good job off the record discussing among counsel witnesses, and we wish to put as the next witness for the Milk Innovation Group Ms. Sally Keefe.

THE COURT: All right. Sounds good. Thank you for those efforts behind the scenes. It makes a difference in the procedures you alluded to. Helps us be efficient.

MR. ENGLISH: Before we mark them, I'm going to hand out what has been previously submitted as Exhibit MIG-5 and Exhibit MIG-5A, and I have a comment on Exhibit 5A. But if I may approach, your Honor, I want to give you a copy first.

THE COURT: Yes, please.

MR. ENGLISH: And the court reporter a copy.

We have 15 single-sided copies unstapled, because they were stapled last night, of 5 and 5A for USDA.

I have copies for the audience of both 5 and 5A.

THE COURT: Let's go off the record. Come back at 11:25 a.m.

(Whereupon, a break was taken.)

THE COURT: It is 11:25. Let's reconvene.

Technical issues resolved. Our witness is ready to talk to us.

Mr. English.

MR. ENGLISH: Thank you, your Honor.

THE COURT: I didn't swear in the witness. I'm

sorry.

MR. ENGLISH: Oh, thank you.

THE COURT: Please raise your right hand.

SALLY KEEFE,

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

THE COURT: Your witness, Mr. English.

MR. ENGLISH: Thank you, your Honor.

So let me start by saying that before and during the break we handed out what was submitted as Exhibit MIG-5, and I'll comment on some modifications to what was submitted this morning, Exhibit MIG-5A.

But if we first have them marked. I believe we are now up to Exhibit 110. I would like Exhibit MIG-5, which is Ms. Keefe's testimony, marked as Exhibit 110, your Honor.

THE COURT: Actually I had -- I had Gallagher's last exhibit as 110. So this should be 111, your Honor.

MR. ENGLISH: Thank you, your Honor.

THE COURT: So marked.

(Thereafter, Exhibit Number 111 was marked for identification.)

MR. ENGLISH: And then Exhibit MIG-5A as Exhibit 112, your Honor.

THE COURT: Yes. Exhibit 112 is marked for identification. This was MIG-5A.

(Thereafter, Exhibit Number 112 was marked for identification.)

MR. ENGLISH: And that is a 27-page -- 28-page document.

(Court Reporter clarification.)

MR. ENGLISH: So I'm going to start by making -- just noting some corrections because we did upload, I think, last night or early this morning, what is now marked as Exhibit 112, also known as Exhibit MIG-5A, and I wanted to note that there are three changes.

First, to some of the colors, to clarify the colors on page 3. The colors just didn't come out the way we intended, so we have what is now in front of everybody, and also we have resubmitted to USDA, colors have been changed.

On page 15, there was a legend issue. So page 15 now has the correct legend referencing Order 51.

And then page 22, there was a title modification. For page 52 -- or page 22. Page 22.

So those are the three changes, and they are now online. In case somebody had downloaded and printed out from this morning, those are the differences. But they are all in the corrected versions that have been provided to your Honor, the court reporter, to USDA, and the audience.

The next administrative matter, your Honor, is that this witness, of all the witnesses we have had so far, does not have a business address. And it is my understanding from a prior hearing what she has done instead is she has provided her address confidentially to

the court reporter.

THE COURT: Yes, exactly. Yes, again, the concern is personal identifying information being released unnecessarily to the public that would cause any harm. So, yeah, I think that -- that was a suggestion, what I suggested. Well done.

MR. ENGLISH: Thank you. All right. With that, we will get started.

DIRECT EXAMINATION

BY MR. ENGLISH:

Q. Good morning, Ms. Keefe. Could you state your full name and current professional work?

A. Good morning. My name is Sally Keefe, S-A-L-L-Y, K-E-E-F-E. I'm the owner and principal of skFigures, a company that provides consulting services to all verticals of the dairy industry.

Q. On whose behalf are you appearing today?

A. I'm here today as a representative of the Milk Innovation Group, MIG.

Q. What is your educational and professional background?

A. I received my BA in economics from Middlebury College and my MBA in finance and entrepreneurship from the University of Colorado. Before entering the dairy field, I worked as an environmental economics and policy consultant.

Then in 1996, I joined Horizon Organic Dairy where my work there focused on operations and milk procurement.

In 2003, I joined Aurora Organic Dairy as supply chain director as a key member of the team that launched that new, innovative organic dairy company. I served in that and other roles in supply chain management before I became the vice president of legal and government affairs for Aurora Organic Dairy in 2007.

I served as Aurora's VP of legal and government affairs until 2012. At that time -- and during that time, I directed the company's legal, regulatory, and legislative activities in both the dairy and organic certification policy areas.

In 2012, I left Aurora Organic Dairy and founded skFigures, my own firm. I provide management consulting services, as well as technical and policy expertise to agricultural and food businesses. I have a particular expertise in Federal Milk Marketing Orders and have testified in prior FMMO proceedings.

Today my clients include farmers, agricultural cooperatives, dairy processors, corporations, trade associations, as well as investors.

Q. And what kind of work do you do?

A. As part of my work as a consultant, I routinely work with data from both processors and Federal Milk Market Order MA, Market Administrator, reports. I'm very familiar with the handler reporting of receipts and utilization to the MA's, the monthly handler producer settlement fund obligation statements, select the computation of obligation, as well as, like, producer

payroll reporting, and the related FMMO reports and data.

As a routine part of all of this work for my clients, and when I was an employee of handlers, I regularly considered the components in milk, so both at test and then also on a skim basis.

Q. Have you filed or assisted in filing of handler Market Administrator reports?

A. Yes, I have been doing that sort of work since the mid '90s at Horizon Organic Dairy. Horizon used co-packers, and I was the person at Horizon that provided the information to the co-packers where -- in order to do the monthly MA reporting.

And then at Aurora Organic Dairy, I was the person that did all of the MA reporting until I left the company. And then since leaving Aurora, I have helped my clients with their MA reporting.

Q. So you used a term that has not, I think, been used so far in the record. And so for clarification, what are co-packers?

A. Oh. Co-packers are when a dairy -- when a business might outsource some of their manufacturing. So other terms that you hear for this in business would be like contract manufacturing, stuff like that.

So Horizon did not at that time, when I was an employee at Horizon, didn't own any of its own manufacturing facilities, and so all of its processing was done in -- in plants that were owned by third parties.

Q. And for all those co-packers, you provided,

basically, the MA reporting data for Horizon to them so they could use it in their handler reports, correct?

A. Yes, that's correct.

Q. When you say you regularly considered the components of milk both at test and on a skim milk basis, what do you mean?

A. Well, as we have all heard here in this proceeding over the last week or so, the information that the MAs collect as far as the milk, it really matters what's in the milk. And so what we're talking about there are the butterfat tests, the protein tests, the other solids tests, solids nonfat test.

And so from both, you know, FMMO reporting and compliance perspective, I consider that sort of information. And then, quite frankly, that information is also very important for the routine operation of all sorts of dairy processing operations.

And so in my supply chain roles earlier in my career, you know, that was the sort of information that I routinely considered to figure out, you know, which milk do I want to have at what plant on what day, you know, what is going to be the best milk supply for a particular processing activity, for a particular production run, things like that.

MR. ENGLISH: Your Honor, at this time I move that Ms. Keefe be recognized for this proceeding as an expert in Federal Order compliance, especially the financial impacts of regulations on milk producers and processors.

THE COURT: Any objections?

I so find.

BY MR. ENGLISH:

Q. Now, Ms. Keefe, later in your testimony, you are going to discuss within what is Exhibit 112, a portion of 112, a survey that you conducted for this proceeding, correct?

A. Yes.

Q. Have you conducted surveys like this one you'll discuss later in the past?

A. Yes, I have, both for -- both for clients earlier in my career when I was working for another consulting firm, within my own business, and then also, you know, as an employee, at both Horizon Organic Dairy and Aurora Organic Dairy.

Q. When was the first study that you can recall?

A. So the first one that I recall is very early in my career, so in the early '90s, a really fun study for the American Water Works Association, where we were looking at the feasibility of connecting small -- smaller water treatment plants and whether that would provide more efficiencies for their operations and assist with their compliance with -- compliance and cost, really, for that one.

Q. And before this proceeding, have you ever sort of done a count of how many of these kinds of surveys you have done?

A. No. I had never tried to count up anything like

that until you asked me that question.

Q. So with that -- okay. I'll ask you the question. So how many do you think, approximately, you have done in your time since the 1990s, if you can -- if you can have a round number?

A. So I would say a round number would be somewhere you know, as far as like something as broad as what we're talking about here, we would probably be talking in the neighborhood of, like, one a year or so. So, you know, 20-ish.

Q. Is it fair to say these kinds of surveys are conducted in order to provide valuable business insights to your employer or its clients or your clients?

A. Oh, absolutely. You know, to provide benchmarking. To, you know, help find efficiencies, you know, for -- you know, for an organization that is doing a lot of contract manufacturing. To compare different vendors, different suppliers, things like that. There's a lot of reasons why people do this sort of -- these sorts of comparisons.

Q. Is there anything unusual in this survey that you conducted for your testimony?

A. Well, first, I have to say, the most unusual thing about this particular project was the really short and tight timeframe that we had to put this data -- put this dataset together and analyze it and maintain the confidentiality of the data while we were doing that. You know, honestly, the short timeframe made participation a

challenge for some of the organizations. We started with the members of the MIG group, then Albertsons, and Kroger joined the work. And with the short timeframe that we're all operating under here, you know, it was -- that was definitely a heavy lift.

Q. Did you make any decisions to -- you know, of which entities were selected as opposed to which data you got for use in the survey?

A. What -- when you --

Q. Did you exclude any entity because the results were inconvenient?

A. No. I didn't exclude any entities because the results were inconvenient. There is one member of MIG whose data is not included in the survey because the terms under which they procure their milk are -- are very different than the rest of the survey group.

Fairlife, which is a product that we have heard a fair bit about over the last week now, is a high protein, high solids product. It's -- and they -- the milk that they bring in starts off at much higher component levels, and they have very different procurement terms for their producer milk receipts than the other plants in the group.

Q. Did you receive any data, for instance, that you couldn't use because it didn't have -- you know, didn't meet other requirements?

A. Oh, absolutely. There was -- we had all the usual data problems. We had the incomplete data. We had the data that doesn't necessarily make sense, so you need to

go to a secondary source, things like that.

And so for this data, the time period that we looked at was January 2021 to December 2022. For most of the plants in the survey group, that means that their MA report data has gone through the Market Administrator audit process, and so is frankly like very, very robust and double-checked.

As you get later in the period, like in the back half of 2022, those audits haven't been completed yet, and so you will still find, like, a stray thing in there where you will be like this -- this is out of line, this number doesn't seem to be correct. And so then I would work with the participant to look at a secondary data source, like their internal receiving reports, things like that, so that we made sure that we were using accurate information.

Q. So one other item that's unusual is primarily this data is audited by the government, correct?

A. Yes.

Q. And did you use weighted average data?

A. Yes, I did.

Q. Did you use any estimated data?

A. I did not use any estimated data. And so if -- if I wasn't able to get the full 24-month series for a plant, then they were not included in the study.

Q. So what is MIG's position on Proposals 1 and 2?

A. So MIG is opposed to Proposals 1 and 2. My testimony today is based on my analysis of both USDA's data on the component tests and producer milk by order,

which I believe is Exhibit 17, and the data that I collected from the fluid milk plant survey on their producer milk receipts.

Q. What did you do first?

A. Well, first, I considered the current skim milk formula factors, along with the fluid milk standards of identity, and compared those to Proposal 1. And for simplicity here with my testimony, I'm just going to refer to Proposal 1, but what I have to say applies equally to Proposal 2. Like there's not -- it's -- think plural proposals.

Q. So for this first part of your exercise, what did you find?

A. Well, looking at pages 3 and 4 of Exhibit 111, my written testimony, you will find a table where I compare the four relevant standards for the milk component factors. The current skim formula component factors are found at 7 CFR, Section 1000.50. Then I review the skim factors from Proposal 1, and next the federal and California composition standards for fluid milk. The federal fluid milk standard of identity is found at 21 CFR, Section 131.110. In my written statement I provide the citation to the California composition standard.

Q. So let me interrupt for a moment, please.

Yesterday, in helpful questions from USDA that were directed to the HP Hood and Shehadey witnesses, there were questions asked about, you know, Y-axis labeling

issues, which I believe happened because you wanted the document to be as large as possible, correct?

A. Yes.

Q. So why don't we see if we can address that issue ahead of time.

So for pages 1 through 24, how would you know -- how would someone know what the Y-axis is?

A. So in Exhibit 112, for pages 1 through 24, the Y-axis is going to be the first part of the title. So like on page 1, it would be the Y-axis is referring to protein as a percent of skim milk.

Q. And that would be true for whatever that first part is through page 24, correct?

A. Yep. All the way through page 24.

Q. And how about pages 35 through 27, what are -- what is the Y-axis?

A. 25 through 27 is just a -- is a count. So it is just the number of plants. And so the Y-axis there is number of plants, and it runs from zero up to 32.

Q. So now let's continue to what you did first. You were referring to the federal California fluid milk composition standards?

A. Uh-huh. So -- so one thing to bear in mind is that the federal and California fluid milk composition standards are expressed for milk, not for skim in those regulations.

And so for an apples-to-apples comparison with the current and proposed FMMO skim milk price formula factors,

I converted the composition standards to a skim basis. That's just an algebra conversion. It is nothing -- no econometrics, nothing like that. It is just algebra. So it is just removing the butterfats that we can talk about the milk on only the skim, the skim basis.

Q. And you are not going to read those tables into the record, correct?

A. No. Those tables are in my written statement, and I don't see any -- we need to take the time to read the table into the record.

Q. That's Exhibit 111.

What did you do next?

A. So next I looked at USDA's data in Exhibit 17, which was formally known as USDA Data Request Table 2. And that data and information provided by USDA shows -- shows the components by order, by month, from 2000 to the present. I was most interested in the 24-month period of January 2021 to December 2022 as that was also the study period for the survey.

Q. So your results are found on charts -- on pages 1 through 4 of what is now Exhibit 112?

A. Uh-huh.

Q. "Yes"? Not uh-huh?

A. Yes.

Q. So if you would now turn on your screen, let's start with the page 1.

A. Great.

So on -- so here, on page 1, we have the protein

percent of skim by FMMO for January 2021 to December 2022. These are the seven multiple component FMMOs. So we have the Northeast, the Upper Midwest, Central, the Mideast, California, the Pacific Northwest, and the Southwest here. And those are the colored curves.

And then the yellow line at the bottom is the current skim milk formula factor for protein, and the orange line in the middle is the proposal skim milk formula factor for protein.

Q. So what does this data show for you?

A. So to me, what this data shows is that there is both a very distinct, as you would expect, seasonal pattern to the component level of protein in the Federal Order producer milk receipts. Generally speaking, the protein levels are highest in the winter months and lowest in the summer months.

It also shows that there is a fair bit of regional variation. We have got Order 1, the Northeast is the black line that is found at the bottom of the group. And then we have got Orders 124 and 126, so the Pacific Northwest and the Southwest, the purple and blue lines, near the top -- at the top.

Q. So let's move forward now to page 2 and move forward quickly through other solids.

A. Okay. So for other solids, as has been discussed previously in the hearing, it doesn't have the same -- it doesn't have the same seasonal pattern as what you would find with the protein or the nonfat solids information.

I do note that there are some differences between the orders, but, you know, quite frankly, they are -- they are grouped pretty close together, and it doesn't -- it doesn't have a distinct seasonal pattern.

Q. And just for clarity, you used the same colors throughout these. So in other words --

A. Yeah. So --

Q. -- the yellow line is the current standard, the orange line is the proposal, and all the colors you described previously are the same, you didn't change from page to page?

A. Right. I didn't change from page to page. So, like, the black is always the Northeast, and purple is always the Pacific Northwest, and all the other colors stay the same.

Q. So now let's turn to page 3, nonfat solids.

A. So, again, on the nonfat solids page, that is very much following the same seasonal pattern as the protein, with much higher levels in the winter months than the summer months, and also showing some variation regionally going from the Northeast, continuing across to the west, getting out to the Pacific Northwest in purple.

Q. So go to page 4. What about butterfat?

A. So page 4 has the butterfat on it. And that is -- this chart is the only one where the colors are a little bit different than the others because I have got the butterfat here for all 11 of the Federal Orders. And so we have got Florida is the yellow line down near the

bottom. And then we have also got orange, mustard, and pink to bring in the Appalachian, the Southeast, and Arizona.

And so much like the protein and the nonfat solids, there is seasonal variation to the butterfat data. And the main reason why the butterfat charts are included here in the packet is, you know, a reminder and a reference to be able to have a visualization of what's going on between the milk when you are testing it and it's milk, and then we have got the skim, and we're only talking about part of the milk. And so the other part of the milk is represented here by the butterfat.

Q. And there's no yellow straight line or orange straight line for current or proposed because that's not relevant here, correct? I mean, we have 3.5 is the -- is what the standard is, but there's no -- there's no purpose in the price that we're talking about for them, correct?

A. That's correct. So today, the formulas for the reference prices are calculated at a 3.5% butterfat, but the proposals don't seek to change that in any way. And so this is -- you know, the butterfat tables in the packet of charts is in- -- they are informational.

Q. Did you reach any conclusion about what the yellow line for Order 6 tells you?

A. Well, for Order -- given the previous testimony regarding the correlation between butterfat and solids nonfat, and butterfat and protein, I would expect that the levels of both protein and solids nonfat would be lower in

Florida than, say, the Pacific Northwest because the butterfat in Florida is, you know, so much lower than what is found in other parts of the country.

Q. So what did you do next?

A. So I wanted to examine the actual milk receipts for fluid plants and compare that to this data in -- that we have just looked at on pages 1 through 4. And so, you know, before -- so early in the process, after the hearing notice came out, on behalf of MIG, and under the direction and control of Davis Wright Tremaine, MIG's lawyers, I conducted a survey of fluid milk plant receipts. The survey data is from the actual MA report receipts and utilization submissions made by those plants and the handler obligation statements received, so the report that goes in and the statement that comes back.

And then I received under confidentiality terms the same sort of Market Administrator report information and handler obligation statement information from two non-MIG members, Albertsons and Kroger. I carefully input and double-checked the data from all of the participants.

Q. And in fact, I think you testified earlier, if something didn't make sense, you went back and asked about it?

A. Absolutely.

Q. So can you tell me a little bit more about your dataset?

A. So the survey dataset includes 36 fluid plants from across the country. Of the 36 plants, 32 had skim

component information available. The primary data source was each plant's milk receipts, so their producer milk receipts as reported to and audited by the Market Administrator. As I mentioned earlier, a secondary data source that I used in conjunction with the MA reports were the plant's internal milk receiving component test records. I analyzed the 24-month period of January 2021 to December 2022 and --

Q. Exhibit 112.

A. Exhibit 112, page 28, lists the participants, the FMMO they're regulated under, and there's a little table there that shows the count of participants by FMMO as well.

Q. What are your survey results?

A. After analyzing the data, I developed charts graphing the component levels for four of the orders and a summary chart for all the survey plants in MCP orders. Those charts are found in Exhibit 112 on pages 5 through 23.

I just want to note, there aren't individual charts for Orders 33 and 126 as there were not enough participants from those FMMOs to present that information and maintain confidentiality. The -- the summary chart for the MCP orders as a whole does include the data from Orders 133 and 126.

Q. You mean 33, not 133? Correct?

A. Yes. I mean Order 33. We did not just get a twelfth order.

Q. And just to be clear, when you dealt with confidentiality, you -- you basically used the same rule that USDA rule does, that there have to be three separate owners, correct?

A. Yeah. We needed to have three separate owners and, obviously, at least three plants. So there could be a situation where there might be four plants in an order, but if they only had two owners, then I wouldn't include that information in a breakout.

You know, this dataset is unique in that it deals with a group of competitors, and we need to be very conscious of that information and those -- and those relationships to maintain confidentiality of each participant from one another.

Q. So what charts did you develop?

A. So I developed four charts each for Orders 1, 32, 51, 124, and the MCP orders as a group. Each order has a chart that shows the surveyed plants' weighted average protein, other solids, nonfat solids, and butterfat component levels. These actual fluid plant producer milk receipts are compared to that same data for the order as a whole, and so that's the data from Exhibit 17, Data Request Table 2, as well as the current skim formula factor and the Proposal 1 skim milk formula factor.

In every chart I track the FMMO order-wide data, so that would be the Exhibit 17 information in green and the survey participants' data in blue. And then like the first three charts on pages 1 through 3, the skim milk

formula factors, the current is in yellow, and the Proposal 1 factors are in orange.

You know, my goals were to compare how the actual fluid plant receipts stack up next to the order-wide data, and then I wanted to compare the fluid plant receipts to the current and proposed skim milk formula factors.

Q. And before we review those pages, what did you do next?

A. So I also looked at on a plant-by-plant basis, for the 32 plants that we have the skim component information for, whether they were above or below the proposal levels, by month, for the 24-month period. For this, I looked -- you know, like I said it is only the 32 plants that have data available. I didn't do any sort of estimating for the four plants that are in butterfat skim orders and don't have and -- and simply didn't have comparable data and information available.

Q. What conclusions did you reach?

A. Well, so my three key takeaways from the data were that Class I plants routinely receive component levels below the average level for the order, that Class I plants routinely receive component levels below the Proposal 1 levels, and that there is remarkable seasonal and geographic variation in the components as well.

Q. How does the data support your conclusions?

A. You know, the data to me, it affirms what, you know, you would -- what you would infer, that the incentives created by the current FMMO skim component

formula factors are that, you know, it makes sense to send the higher component milk to where it can be best used, and the higher component milk is best used in the manufacturing classes. And so I wasn't super surprised to see that -- you know, it's not all the time, but a fair bit of the time that the fluid plants in this survey are receiving -- their producer milk receipts are below that of the order as a whole.

Q. That's not a criticism, is it? It is a logical, reasonable business decision, correct?

A. Oh, absolutely. I mean, those are -- that's where that milk has more value in those uses than it does in a fluid use. Like, you're going to be able to produce more cheese, you are going to be able to dry more powder. Like, that's where it should go. That's -- that's what we want to have happen.

Q. So what does the actual fluid milk receipts data tell you about this Proposal 1?

A. So to me, the actual fluid milk plant receipts data show that USDA really must deny Proposal 1. The fluid milk plant survey data, like the FMMO data, does not support a national standard set at the Proposal 1 levels. Exhibit 112, pages 25 to 27, clearly show that much of the time most of the fluid milk plants surveyed are below the skim component factors in Proposal 1. The components received by Class I plant are not consistent. They vary from FMMO to FMMO. They vary seasonally. And -- but I do know that even in the wintertime, there are survey plants

receiving milk with components below the proposals.

Q. When you say in the wintertime, because that's the one time you would expect the components to come up?

A. Yeah.

Q. So let's go through some of the charts, not -- we'll go through some of them as samples and then not cover every single one.

What does page 5 show?

A. So page 5 shows protein for the Northeast. And so this is where we have got the survey group is in blue; the FMMO is in green; the current formula factor is the yellow line at the bottom; the proposal formula factor is the orange line at the top.

And so what we're looking at here is, you know, that most of the time the order as a whole for the Northeast, as well as the survey plants, are running along in between the current level and the proposed level, and also, that the plants in the survey group for the Northeast closely track the order as a whole on their milk receipts.

Q. They track the order as a whole, but if we look back at page 1, Order 1 was the lowest throughout the whole country, correct?

A. Yes. Order 1 is the lowest for the MCP orders. We don't know what that would look like for the butterfat skim orders.

Q. So what about the -- what -- what does this tell you about seasonality?

A. It tells me that the components are lower in the summer than the winter and that, you know, going back to high school math, you've got a nice cosign function there.

Q. So let's turn to page 6, and we'll talk about other solids just once. So page 6 on other solids.

A. So here we have got the other solids in the Northeast. This is pretty similar to what we were looking at on page 2. You know, the survey, it -- there is not the same seasonality with the other solids as we have got going on with the protein, and the -- and it's very much like above and below the proposal levels and -- but not on a distinctive seasonal basis like the others.

Q. Let's turn to page 7.

A. So page 7 is nonfat solids for the Northeast. Again, in the Northeast, the survey group plants are very closely tracking the order as a whole, and I would note that both are, for the most part, most of the time below the level of the proposal.

Q. Let's turn to chart 8, which is butterfat, and we're only going to talk about butterfat once.

A. Yeah. So, again, the butterfat pages, so here on page 8, and then continuing on as the fourth one in each group, the butterfat -- the butterfat charts are provided for informational purposes. It shows -- butterfat shows the same seasonality as protein and the nonfat solids, and for the Northeast, the butterfat here is tracking really close between the survey group and the order as a whole. The survey group is maybe a little bit lower but not a

lot.

Q. So we're now going to turn to Federal Order 32, the Central order, which is page 9. Could you tell us what's shown on page 9?

A. So page 9 is showing the -- the protein for the Central order. The survey group is blue; the Central order as a whole is in green. And so what we see here is that for the survey group plants, they are actually receiving for the -- for the -- they are receiving milk with lower protein levels than the order as a whole.

Q. Every single month?

A. Every single month for this order, and for protein.

Q. And there's a couple months within this where the protein for seasonality just barely breaks the current level, correct?

A. Yes. For the fluid plants. Now, the order as a whole is not as close to the -- to that current level, but the fluid plants in the Central order are very close to that current level that are in the factors today.

Q. Let's turn to page 11, which is nonfat solids for the Federal Order 32, please. And tell us what that shows.

A. So this is pretty similar to the story that we saw for -- for protein. There are -- with respect to the nonfat solids, there's a little bit more of the time when the survey plants are exceeding the Proposal 1 level, but most of the time they are not. And the survey group

plants are showing levels that are lower than that of the order as a whole.

Q. So now we're going to turn to Federal Order 51, which is chart 13.

A. So chart 13 is Order 51, so for California, sort of the hybrid case here between the Northeast and the Central order. So, you know, the beginning of the data is a lot more like the Northeast where the survey group plants are very, very close to the order as a whole, and then in the later months, the protein levels for the survey group plants are below that of the order. I also note that in California the component levels, both for the order as a whole and the survey group, are much higher than they were in the Northeast.

Q. And that quite logically because -- partly because of the composition standards in California --

A. Yeah --

Q. -- or you don't know?

A. To me -- to me, it's because California has been using a component pricing system for a very long time, and so, you know, producers in California have been focused on components for a long time.

And then there's another big difference when you are thinking about comparing between the orders. The utilization of the milk in those orders is not the same. And so, generally speaking, there are more manufacturing uses for milk out in California than -- so more milk being used in Classes III and IV, than what is going on out in

the Northeast, and so that would also create incentives to have more high component milk in the pool because, you know, those -- that higher component milk is, you know, valuable and needed for the manufacturing classes.

Q. So now let's turn to page 15. And first I'm going to ask you to talk about what it shows, and then I have one further question.

So nonfat solids in FMMO 51, California, what does this show?

A. So here we have got nonfat solids for FMMO 51. And this is, you know, very similar to what was going on on their protein chart, where at the beginning of the study period, the -- at the beginning of the study period, the survey group plants and the FMMO 51 data are very much aligned. And then you see the -- you see the survey group plants drop below Order 51 in the later months, like towards the back in 2022.

Q. And before you actually testified, I corrected the fact that on page 15 the legend had said 32 and was resubmitted earlier this morning is now 51.

A. Uh-huh.

Q. Did you confirm that, nonetheless, this was Order 51 data as opposed to 32?

A. Yes. The data here is for Order 51.

Q. So it was literally just a typo in the legend, correct?

A. I believe -- I believe so.

Q. However it happened.

A. Yes.
Q. So if you turn to page 17, please.
A. So here on page 17 we have got the chart that shows the protein for Order 124, the Pacific Northwest. So it's got a similar pattern to California where the survey group and Order 124 are close together at the beginning of the study period and then the -- for the most part, later in the time period, like most of 2022, aside from that one strange month in the spring, we have got the survey group plants dropping below the order as a whole.
Q. And so page 19, please.
A. So 19 are the solids nonfat for the Pacific Northwest. Very similar in terms of the relationship between the survey group and Order 124 over the course of the study period. I would note that the overall level here, so the nonfat solids for Order 124, is very much higher than what we have -- than what we see in Order 1, for example, so the first group of charts that we were looking at.
Q. All right. So now let's turn to page 21, which I believe -- why don't you tell me what that is.
A. Yeah. So page 21 shows the protein levels. This is a weighted average across the participants. These are for the plants that are regulated on Orders 1, 32, 33, 51, 124, and 126. So this includes all of the participants. We did not have anybody in the survey that operates a fluid plant in Order 30.
Q. So I note with this one, though, there is no green

line for the Federal Order.

A. Yeah, that's correct. Like, for me to be able to add the Federal Order green line here, there would have been a lot of estimating and a lot of math under the covers, because the -- the amount of -- the distribution of the plants across in the survey, and so the -- and the distribution of the volume of their milk in the survey doesn't match the distribution of milk in those six orders. And so, like, doing the weighted average, it -- the amount of information that would be under the covers, I did not think that would be a fair comparison.

Q. And moreover, involve estimation, and you did not do any estimates?

A. I did not do any estimating.

Q. So turn to page 23, please. And please tell me what that is.

A. And so this is the same chart as we were just looking at on page 21, but this is for nonfat solids. So, again, it is the plants on the six multiple component orders. And what we see there is that for most of the time the plants are below the Proposal 1 levels. They are definitely receiving milk that's very much above the current levels. But there's only, you know, a little bit of time on the average, and so this is a weighted average for all of them, only what we're seeing there is in the winter months in 2021 and then again in the winter months in 2022, that the plants are receiving nonfat solids above the proposal level, but the rest of the year they are not.

Q. So in the spirit of time, we have already briefly discussed tables 25 through 27. But could you still, looking just at one of them, help out because there's increments like there were yesterday, correct?

A. Yes. Happy to help. And now wishing the font was larger on the Y-axis.

The -- so what we have got here is a count. This is for the 32 plants that we have the component data for, and it is showing whether or not the plant is above or below the Proposal 1 skim formula factor on their actual producer milk receipts. And so, for example, for January 2021, what we're seeing here are 19 plants of the 32 below the proposal protein percent and then 13 plants above.

Q. And that would be similar for the following two pages --

A. Uh-huh.

Q. -- for other solids and nonfat solids, correct?

A. Yeah. And so, like, if you look at June of 2021, June on the protein chart, that would be one plant up there at the top where they are above the proposal level for the skim.

Q. And in August of 2022, it was zero?

A. Yes. That's right.

Q. So how does your data connect up to the theories underlying the Federal Milk Order system?

A. So the FMMO system is a minimum pricing system. And I believe that the FMMO system needs to recognize that

Class I plants are not receiving the components found in Proposal 1 on an average basis, and moreover, because of seasonal variation, there are months when they are receiving components closer to the current level. And --

Q. Go ahead.

A. And so I just want to emphasize again that our system with the Federal Order system, it is a system of regulated minimum prices.

Q. So how does this all impact Class I milk?

A. Well, so we have seen increases in components over the last 20 years, and at the same time that that's been happening, fluid milk is on a downward trajectory. It is honestly, for someone like myself who has been focused on the fluid side of our industry, it's a discouraging trend. And it is -- it's a real problem for our industry, the decline in Class I sales, on an absolute basis, on a per capita basis.

And while we have seen the components going up with -- we haven't really seen an increase in products necessarily, you know, touting the components. And the components that are out there that do make those claims, so like a Fairlife or, you know, something that has some added solids in it, those -- those processors undertake significant investment in technologies like ultra-filtration to concentrate the protein or they undertake the expense of adding solids. And when you add solids using NFDM or condensed skim, you are -- or if you are using ultra-filtration processing technologies, you

are adding significant costs, you are adding large costs beyond the milk itself.

And to me, I think that if more could be done to get consumers to recognize the value of the components in fluid milk, I think that processors would have pivoted in that direction. They would be doing it because all -- fluid processors are trying so hard to increase sales.

So, you know, the component increases, you know, claimed by NMPF and National All-Jersey, they don't change the value proposition when it comes to fluid milk, and raising Class I prices based on components would be taking, you know, even more money from Class I, that it's going to have a really hard time recovering in the marketplace.

Q. Do you have a concluding comment?

A. Proposals 1 and 2 presume that the Class I fluid market is similar to Classes III and IV when it comes to component valuation, and this just isn't true. Yesterday, we heard from Dr. Van Amburgh that the changing genetic -- was that yesterday or was it Monday; God, I think it was Monday -- that changing genetics also increases the volume of milk that the cows produce. And that's honestly where the value is for Class I. It is in the volume; it is in the butterfat. And when it comes to the volume, Class I pays for those additional hundredweight. And Class I plants don't derive value once you move beyond the butterfat, and they also don't receive annually, consistently, on a seasonal basis, they just don't receive

these components. And so Proposals 1 and 2 need to be denied.

MR. ENGLISH: And with 24 seconds left in my one hour, this concludes the direct testimony, and the witness is available for cross- examination. And I note that it is almost 12:30.

THE COURT: Yes. Unless someone has an objection, I suggest we take lunch, come back at 1:30.

(Whereupon, a luncheon break was taken.)

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WEDNESDAY, AUGUST 30, 2023 - - AFTERNOON SESSION

THE COURT: Okay. On the record. We're back from lunch with the cross-examination of Witness -- Cathy?

THE WITNESS: Sally.

THE COURT: -- Sally Keefe.

I forget who we had up about to commence cross. Mr. Miltner, I think.

MR. MILTNER: Thank you, your Honor.

Before I get started, so I don't have to interrupt, I'm going to grab some exhibits from USDA, if I could.

THE COURT: Yes, sir.

MR. MILTNER: It is 15, 17, 33, and 52.

CROSS-EXAMINATION

BY MR. MILTNER:

Q. Okay. For the record, my name is Ryan Miltner. I represent Select Milk Producers.

Hi, Sally.

A. Hi, Ryan.

Q. How are you?

A. Good, thanks. I feel like I'm louder.

Q. How was your lunch?

A. Lunch was great. Thank you.

Q. Excellent?

My first question is about the plants that you included in -- in your data here. And so I'm looking at the very last page of your 5A, which is Exhibit 112, and if you want to grab I think it's Exhibit 33, let me know

when you have got papers situated.

A. Okay. I have got 33 here.

Got it.

Q. Okay. So looking at page 28 of your exhibit, you have plants from Albertsons and from Kroger included there, correct?

A. Yes.

Q. Okay. So I'm trying to match them up against what's on Exhibit 33. I want to start with Albertsons. So the one I'm looking at, there's one in Denver. That one shows up on the list.

A. Uh-huh.

Q. There's one in Order 51, City of Commerce and San Leandro. I see Safeway plants listed on Exhibit 33.

A. Which page of Exhibit 33, Ryan?

Q. I'm sorry. I'm looking at the very first page of it.

A. Got you.

Q. And I don't see really any on here that are -- they are listed alphabetically on there, right, not by order?

A. Yeah.

Q. Okay.

A. Yeah, they are not -- my list here is sorted by order, and then it's alpha with the plant and the city name. And Exhibit 33 is, as I understand it, the list that USDA has on its website of regulated pool distributing plants, and there's usually like two tabs in

the file. There's a pool distributing plant file -- there's a distributing plant tab and then there's a supply plant tab. And so I believe that 33 are the distributing plants.

Q. Okay. And I think it is because at least I'm pulling that from the top that it is distributing plants. I think 34 was the supply plants.

A. Okay.

Q. Maybe I can just shorten this question. If you look at page 2 of that?

A. Of thirty --

Q. Of 33.

A. Yeah.

Q. Okay. About two-thirds of the way down there's a bunch that are listed as Safeway stores?

A. Yep.

Q. Do you know if those are the Albertsons plants that you reference?

A. Yeah. So on this page, page 2 of Exhibit 33, so like where you see Safeway Belleview, Safeway City of Commerce, Clackamas, Denver, San Leandro, and then Tempe, those -- Safeway and Albertsons are one and the same now, although the pool plant list doesn't necessarily -- hasn't necessarily updated the names on here as ownership has changed of the plants.

Q. Right.

A. And so like the very first plant on my list is Albertsons in Hatfield, PA, and that's the same as the

third row down on page 2 of Exhibit 33, Lucerne Dairy in Hatfield, PA.

Q. That was going to be my next question, if that was the plant. Thank you.

I don't see the Safeway plant in Tempe listed in your survey. Is that one of those that had perhaps data issues?

A. Yes.

Q. Okay. Similarly, as I look at Exhibit 33 -- and refer to it, if you'd like, but you may not need to.

A. Okay.

Q. Kroger plants in Indianapolis and Santa Ana, California, data issues?

A. Likewise.

Q. Okay.

A. And as far as that goes, Albertsons and Kroger joined the -- joined the study late. And so the ability of those participants to be able to cure any data problems was more limited just because of the tight timeline.

Q. I appreciate Mr. English's question that there was no data excluded for convenience sake. Not that I would have expected that, but appreciate that statement from him.

I'd like to look at now your written statements, which I think we marked as Exhibit 111. And I'm looking at page 3 and your table there.

A. Yep.

Q. Okay. And you have four different let's call them

categories or different types of standards listed there, correct?

A. Uh-huh.

Q. The one listed as current, that is the current -- current standards for the Class I base price, correct?

A. Yes. So those would be the current skim formula standards that are used in just the skim portion of the Class I.

Q. And then so the second is the same -- the same information, but as it would be under Proposals 1 and 2, correct?

A. Yes. If Proposals 1 and 2 were adopted, these are the levels -- the factors that have been proposed for those.

Q. So those two lines represent standards that are applicable to the pricing formulas under the Federal Order?

A. Yes. Those are pricing standards, absolutely.

Q. Okay. And the third line, that's a federal standard -- you have it listed as a federal standard. As I understand that, that is the -- that is the standard -- the standard of identity for milk under FDA regulations, correct?

A. Yeah. So that's FDA's composition standard for milk, not -- it's not a pricing standard.

Q. And the same -- the fourth is California's composition standard for bottled milk, correct?

A. Right. And, again, that's a composition standard

for the milk, it's not a pricing -- it is not part of the pricing formulas, those two.

Q. So since they are not part of the pricing formulas, help me understand the importance of those two lines to your opinions and your analysis.

A. So for me, those two lines -- so if you take those and you keep going into the milk, if you take the federal standard and you keep converting, you are going to be at 8 grams of protein per serving on a nutrition fact for fluid milk, and that's what our -- that's what consumers of our products see.

And then what the California standards -- I'm not a -- I'm not a California girl. I'm not quite as good at going all the way to the grams per serving for California, but I believe that that one is higher. I think it is 10-ish. And so, again, like that's -- that's what consumers see and expect.

Q. Okay. Okay. Can we turn to page 6 of your statement, please?

A. Sure.

Q. The very first paragraph under section E, you write, "The fluid milk plant survey data, like the FMMO data, does not support a national standard set at the Proposal 1 levels. Exhibit MIG-5A, pages 25 to 27, clearly show that much of the time the fluid milk plants surveyed are below the skim milk component factor levels in Proposal 1."

And I'm drawing -- well, when I look at your

tables and your graphs --

A. Uh-huh.

Q. -- from which you draw those conclusions, are these the same -- are those the same type of charts that were presented yesterday by, I forget if it was both Hood and Shehadey, but the same data -- or same information you are trying to relate?

A. Yes. So that's the same type of information that both Hood and Shehadey -- the Hood and Shehadey witnesses yesterday were working with. But in the case of Hood and Shehadey, they were each talking about their plants only. They weren't talking about the group as a whole.

Q. Can you grab Exhibit 112, your graphs and tables?

A. Yep.

Q. And at the same time, if you would grab Exhibit 17.

A. Yep.

Q. Okay. So we're going to -- I want to look at the first page of Exhibit 17 and page 5 of Exhibit 112.

A. Yep.

Q. The blue line on page 5, that is your surveyed -- tell me if I have got this right -- your surveyed protein among your group in Order 1 over that defined period.

A. Yes. And that would be protein as a percent of skim.

Q. And there's a -- they overlap or they are very close, but there's also a green line there. That's the Federal Order data for protein and skim, correct?

A. Yep. And that Federal Order data is also as protein as a percent of skim.

Q. Okay. The yellow line represents the presumption of protein and skim under current standards, correct, current pricing standards?

A. Yes, under the current pricing standards. It is not the composition standards we were talking about earlier.

Q. Great. So I want to look at -- and the chart, your table, your chart, covers January '21 through December 22nd -- or December of 2022?

A. Yes. It's a 24-month period. It starts in January of 2021 and goes through December of 2022.

Q. If you look at Exhibit 17, on the first page -- and have you seen 17 before? You have looked at it, right?

A. I have indeed seen Exhibit 17 before.

Q. I figured that was a safe assumption.

A. I don't actually think I have ever seen Exhibit 17 on paper before, to be fair.

Q. Now we have.

If I look at the protein test column, beginning right at the top, that's Federal Order 1, beginning in January of 2000.

A. Uh-huh.

Q. If I look at that column for protein test, and I cover 24 months, ending halfway down the page of December 2001. If you were to plot that protein test on

your page 5, that line would be entirely under that 3.1, wouldn't it?

A. So before you would be able to plot the column for the protein test here, because this is showing 3% or -- you know, January of 2000 is 2.99% in milk. And so just like the formula factors, the charts are all as a percent of skim, and so you would need to take the protein test and put it in terms of skim.

Q. So it would be roughly 3% higher?

A. Roughly.

Q. And in which case it pretty well would still be below that yellow line all across the board, right?

A. You are asking me to speculate. But, roughly, yes.

Q. Yeah.

A. Yeah.

Q. And if you flip to page 9 of the MIG exhibit, which is Exhibit 112, and page 26 of Exhibit 17.

A. Got you.

Q. Okay. So we're now looking at the Central order on your graph, and we have turned to the Central order information on Exhibit 17.

A. Uh-huh.

Q. For that same period, January 2000 through December of 2001, those protein tests, somewhat higher than Order 1 but still would fall in large part below that -- that yellow line on your -- your graph, right?

A. Yeah. They would be closer, though, once you did

the -- once you converted them to a skim basis because, like, January of 2000 for the Central order was 3.08% milk for protein, and so once you did the bump to skim, you would be -- I think that one would --

Q. Be really close, if not just over it?

A. I think it would come out just over it.

Q. Okay. But then July of 2000 where it is 2.93, you'd probably land somewhere around 3.05, right?

A. -- 'ish, yes.

Q. Back in your written statement, the part we looked at says -- where you say, "The fluid milk plant survey data does not support a national standard set at Proposal 1 levels."

Is that -- that's your expert opinion?

A. That's my opinion, yes, my -- and I believe Chip qualified me as an expert, so I get to say that's my expert opinion.

Q. He did, and I did not object to that.

Do you think the data in 2000 to 2001 would have supported base prices at those levels given the protein numbers we just looked at?

A. I think they would probably be pretty close. I haven't gone back and looked at them all on a skim basis for those. It is a -- but it seems like they would definitely be closer than --

Q. All right. On the very last page of your written statement, right before your conclusion, you write, "But the component increases claimed by NMPF and NAJ don't

change the value of the fluid milk, and raising Class I prices based on components would be taking more money from Class I that it cannot recover in the market."

Is that your expert opinion?

A. That's my opinion, yes.

Q. Okay. On what do you base your opinion that the Class I handlers cannot recover that increased price from the market?

A. My opinion is based on -- similar to the testimony that we heard from Jed Ellis with Shehadey yesterday about what happens when you -- when as a fluid processor you have got higher component milk that you have made for the California market at, like -- and that meets the California composition standard, and then you are trying to market that to a non-California customer. The price pushback that you get is significant and real. The customers are -- within California, they recognize that that is their composition standard and that they have to pay for it.

When you go outside and you are -- when you are moving outside of California and you are trying to sell that same product -- like, it could be a situation where you are like, look, like, I want to do all -- I want to do all of my production on Tuesdays to California standard so that I have efficient production, less shrink, you know, stuff like that, in the plant.

And then you try to, like -- and then you're sitting there, and you are trying to weigh it, you are,

like, okay, but if I do everything to California standard, then I need to be able to sell everything I made that day. Okay? And if I can't sell it all within the state of California, where am I going to sell it? And then you are, like, okay, well, let's get some sales out, let's try and get more price.

And the pushback is real and phenomenal. It doesn't happen. And you wind up eating those extra costs, and you -- and you are -- you make it -- you have to -- you have to make a decision, and you have to say, okay, that makes sense from -- perhaps from a plant efficiency perspective or whatever to -- to do that that way.

Q. And that's a real situation. But as you describe it, isn't that a function of California's standard and not the Federal Orders standard?

A. Well, if Proposals 1 and 2 were in place, and the Class I processors are paying more for the skim components, you know, they -- I don't think it's fair to expect someone to pay for something that they are not actually getting and actually using and putting in the milk.

And so, you know, what the formula factors imply, the FMMO price formula factors imply, is that if Proposal 1 is adopted, Class I as a group is going to need to go out to its customers and is going to need to say, there is more -- there's more here, and we need you to pay for that. And -- and interestingly, like, because there is today more there in California, as an industry, we have

an example for what happens when a fluid milk processor tries to -- tries to do that with customers in the real world today.

Q. Other than organic processors, when they buy raw milk for Class I use, they buy it based off of the announced Class I price, correct?

A. Typically, yes.

Q. And -- but the organic price is typically a fixed price?

A. The organic prices are typically fixed, non-classified and, frankly, much, much higher than the prices that we have been talking about here.

Q. When a Class I processor sells its products, are they pricing that off of some Class I underlying price?

A. They are using the Class I prices and then looking at their processing, their manufacturing cost, their packaging costs, like, they are putting it all together and taking it out to the market.

Q. In the past we have had some discussions about some of those costs, but things like resin caps, labels, transportation, balancing, all of those things, correct?

A. Even glue.

Q. But the largest proportion of the cost from the plant to its customer is the milk, correct?

A. Absolutely. The milk dwarfs all of it. I mean, we can talk for a really long time about caps and resin and the glue for a corrugated box and pallets and all the rest of it. We can talk about dairy crates and cases. At

the end of the day, the most important thing is the milk itself.

Q. And not in every case, but typically, that milk price fluctuates month to month based on the announced Class I price?

A. Typically, yes.

Q. Were you here for Peter Vitaliano's testimony back on day one?

A. I believe I was, but it feels like it was more than a week ago.

Q. Technically it was -- no, it's just a week, isn't it?

I don't want to pull that out, but I think as I looked at it he thought Proposal 1 would add $0.80 to Class III and $0.41 to Class IV.

For our discussion will you accept that?

A. That -- it rings a bell, Ryan.

Q. Okay. So if we keep a Class I mover based on the average of III and IV, can we suggest that Proposal 1 would add about $0.60 to the Class I price?

A. Yes. Definitely.

Q. Can you grab -- go ahead.

A. Which am I supposed to grab?

Q. Well, I think you were going to say something and I cut you off.

A. It's fine.

Q. 15. Is this one seared into your head like Exhibit 17 is or --

A. Actually, it is not.
Q. Okay.
A. No.
Q. Would you turn to the last page of it, please? And do you see that what's -- it is the third column where it says base Class I price?
A. Yep.
Q. Okay. Do you need a second or two to look at that before I ask you a couple of questions?
A. That would be nice. Thank you.
Q. Yep.
Okay. If you look at the year of 2021, if you look at the base price in January and the base price in December, there's a huge fluctuation there, correct?
A. Absolutely.
Q. About $4, $4.03, correct?
A. Uh-huh.
Q. So over the course of that calendar year, a Class I handler selling to its customers, based on the regulated price alone, is going to pass through $4 of cost changes over the course of the year, correct?
A. For most of the them, yes. I mean, as we have heard from previous witnesses, there is different -- folks have different time frames for those sorts of pricing adjustments, and so not everyone is changing monthly. And so -- but over the course of that year, if you're -- if you are not figuring how to pass along that $4 change, it is going to be a problem for your business.

Q. And this type of fluctuation is just a function of our Federal Order system, correct?

A. It is -- absolutely. It is a function of the way that we price Class I off of III and IV.

Q. If you look at that same column, the change from May to June, one month, is $1.19, correct?

A. Yeah. So for May of --

Q. 2021?

A. Okay. Yeah, those two are $1.19.

Q. So that fluctuation as a result of the order system and our -- the way we select a mover and other factors can cause the Class I price to increase by $1.19 or more in one month?

A. Uh-huh.

Q. By the way, all of our -- are all of the handlers in MIG federally regulated handlers or fully or partially regulated Class I handlers?

A. Yes, they are all going to be either fully or partially regulated. They may have -- there are some members of the group that have plants in unregulated areas completely, like --

Q. Like Hood?

A. All of Hood's plants are fully regulated.

Q. Oh, I'm sorry. But their main plant was in an unregulated area.

A. Oh, yeah. It is located in Maine, but fully regulated on Order 1. And that's a great example of I think what you are trying to talk about, maybe.

Q. Maybe. That's good.

If these handlers can pass through in one month an increase of $1.19, why couldn't they pass through $0.60 if they are all subject to the same regulated minimum price?

A. They may be able to. It will increase the price, and overall, when you increase the prices, that is going to have an impact on consumers. While milk is relatively inelastic, it is not perfectly inelastic, and so volume decreases.

And I would also point out that this volatility of the fluid milk prices that you were showing me on Exhibit 15, that is something that is a real headwind for Class I. Those prices changing all the time for the consumers in the store is not a great thing. When you are competing against other beverage products, other sort of beverages, these -- that have a much more stable price, and consumers know what to expect every single time, it is in my opinion an easier proposition for the consumer to understand what they are getting and why they are getting it and the chart -- and the price they are being charged.

Milk is unfortunately -- fluid milk, our structure that we have in the industry leads to some real consumer -- confusion may be a bit too strong of a word, but it is a headwind.

Q. Are you aware of USDA-collected data on the retail prices of either conventional or organic milk?

A. I'm aware of that data, but I'm not super familiar with it.

Q. You -- have you done any analysis to determine a correlation between the regulated price and the retail price of milk?

A. I haven't done any analyses on -- on those, no.

Q. Would you -- would you be surprised if, in fact, the correlation between the regulated price and the shelf price is not very strong?

A. It would not surprise me.

Q. Have you done any studies or have your members shared any information about the frequency of price changes of their products at the retail level?

A. So I have -- so, yes, our members have shared information with me, as well as, you know, as recently as yesterday in the hearing regarding the -- their price change intervals. And it varies. Some are as much as monthly; some are, you know, less than annually. And so it's -- it runs the gamut.

Q. Is that a price change from your members to their retailers?

A. That would typically be a price change from our member to their retail customer. For the most part, the member -- so I'm going to need to make a little bit of a distinction here. So the survey included Albertsons and Kroger who are clearly also retailers, okay? So the comments that I'm about to make do not in any way refer to Albertsons and Kroger. Albertsons and Kroger participated in the survey. They are not members of the Milk Innovation Group. The members of our group are

processors, and so they sell to a retailer. They do not control the price at the shelf. That is controlled by the retailer.

Q. Do your members keep track at all of what the retailer markets their products for and the frequency of the shelf price change?

A. Absolutely.

Q. Do you -- do you have that data for us?

A. I do not have that data for you. Those could be some -- you -- I believe that members of our group will be testifying over the course of the hearing. If that's something of interest, I would suggest asking them.

Q. All right. I want to change gears a little bit and talk about organic.

You stated that the raw milk price to an organic handler is typically a fixed dollar price, correct?

A. Typically, yes.

Q. And in the rare instance, if it's ever occurred, that the Class I price rises above that, there would be an additional cost, correct?

A. In the rare instance when the Class I price is above the organic, like, fixed contract price, the handler would have to pay the regulated minimum price.

Q. And I'm trying to recall the transactions that I'm aware of, and I can't think of that ever occurring.

With Horizon or Aurora, has that ever occurred?

A. It never occurred during my time at Aurora.

It did actually occur during my time at Horizon.

There were a few times when the Class I prices were high enough, and the organic prices, candidly, were lower then, and the Class I exceeded the -- the organic.

Q. And if the words weren't used by you, I'll use them and see if you agree. An extraordinarily rare occurrence for that to happen, right?

A. And that happened an extremely long time ago. That would have been back in the '90s.

Q. So if Proposal 1 is adopted and the Class I prices are increased, it really wouldn't affect the cost of milk to an organic handler, would it?

A. It would not impact the cost of their milk itself. It would impact the way that their obligation to the pool is determined.

Q. How it's determined or the amount that's calculated?

A. The amount that's calculated, when the formula factors go through to determine the pool calculation.

MR. MILTNER: I don't think I have anything else. Thank you very much.

THE WITNESS: You're welcome, Ryan.

Oh, wait, I have got lots of things that don't belong to me.

MR. MILTNER: Do we want to leave them with the witness in case anybody else wants to ask about them, or would you like me to collect them now?

THE COURT: Let's leave them, but let's remember.

MR. MILTNER: Thank you.

THE COURT: Ms. Hancock.

MS. HANCOCK: Thank you, your Honor.

CROSS-EXAMINATION

BY MS. HANCOCK:

Q. Good afternoon, Ms. Keefe.

A. Good afternoon.

Q. So I want to start off on the data that you collected. You said that you did this through a survey of MIG members; is that right?

A. MIG members plus Albertsons and Kroger.

Q. Okay. Did you ask anyone else other than Albertsons and Kroger beyond the MIG membership to participate in the survey?

A. We also -- we asked Saputo to participate as well. Unfortunately, with the tight timeline, they were unable to participate.

Q. Okay. When did you do the survey?

A. Over the course of the last month.

Q. And how much time would you need to do a complete comprehensive survey to make sure that you got a full response?

A. Well, the survey is what it is. I mean, this is -- this is the complete comprehensive response for the -- for this hearing. I mean, it is what it is. Like, it is complete.

Q. Okay. So you feel like the information that you have is complete enough?

A. Like a lot of projects, if -- if there were more

time, like the plants that -- that Ryan was asking about, like he mentioned like a couple of Kroger plants, he's like, I don't -- you know, I see them here in the list of pool plants, but they are not on your survey list. And, you know, with more time, perhaps, more of the plants could have had a complete 24 months, so that there wouldn't be like -- like, the Kroger facility in Indianapolis, for example, I didn't have a complete 24-month period, so they weren't included.

Q. Okay. Do you know how many Kroger plants there are?

A. I don't know how many Kroger plants there are.

Q. In Mr. Brown's testimony I believe that he said there were 14 Kroger plants.

Were you here for his testimony?

A. I wasn't here for his testimony. 14 sounds -- it could be right, it could be wrong. I don't know, and I don't want to speculate.

Q. Okay. And you know Mr. Brown worked for Kroger?

A. I do know that he worked for Kroger.

Q. Okay. No reason to disagree with him on that point?

A. Well, I think that he may be including some of their plants that aren't necessarily Class I plants. He may be including some of their Class II facilities, some of their other manufacturing facilities in that 14, and that's why I'm a little reluctant to just go with 14.

Q. Okay. And if I'm doing the math on your

Exhibit 112, it looks like you have seven of Kroger's plants listed there?

A. Is that page 28?

Q. The last page, 28 of 28 of Exhibit 112.

A. Uh-huh.

Q. Okay. So if it was 14, that would be about half of the plants surveyed?

A. Yeah. One -- because we were interested particularly in people's component data, Kroger operates -- so, like, over the last month I have seen a lot of this stuff, but one of the things I remember, for example, with Kroger was that one of their plants in -- one of their plants in like the Southeastern order, for example, we didn't have like the complete set, for example. So stuff like that.

Q. Okay. So like Atlanta, you don't have the numbers from Atlanta?

A. Yes. You have found. We have outed.

Q. What about -- and then -- I can't remember which one Mr. Miltner asked you about, but Ohio and Virginia Kroger plants, did you include that data?

A. Does Kroger have a plant in Virginia?

Q. Do you know if they do?

A. I don't know if Kroger has a plant in Virginia. I do know that Kroger has a plant in Ohio and a plant in Indiana, and they were not -- those two plants were not able to comply -- provide complete data.

Q. Okay. What about for the other handlers with

MI- -- that are members of MIG, were you able to get the data for all of their plants?

A. Yes, all of their plants. The MIG members, because we -- the group has been working together for quite a few months, they were a little bit more prepared for my data request than Albertsons and Kroger were.

Q. Okay. So you believe you were able to get all of data for all of the plants for all of the MIG members, with the exception of Fairlife that you said you culled out?

A. Yes.

And then there is one other MIG member plant. Danone has a plant in Salt Lake City, Utah, and that plant is located in an unregulated area, and then is partially regulated, and then does all of its tracking on a butterfat and skim basis. So they are not included.

Q. And that's just essentially because you didn't believe that it would compare apples to apples?

A. Yeah.

Q. Okay.

A. They -- just not like the others.

Q. Okay. And I want to talk for a second about Fairlife. You said that you culled out Fairlife because they have a higher protein requirement for the -- their milk; is that right?

A. Yes. The -- Fairlife's requirements for their producer milk, the milk that they're -- the milk that they are procuring from their suppliers is a very different

situation than this group of plants right here.

Q. Would you consider Fairlife to be something more kind of innovative and a modern way to sell milk to consumers?

A. Fairlife's products are definitely an innovative product. It is --

Q. In fact, it is a patented product, isn't it?

A. Indeed it is.

Q. Okay. And you understand that with that comes the opportunity for a higher premium price that can be charged to consumers?

A. Indeed.

Q. And that's based on the higher protein values that Fairlife requires in its raw milk that it takes in that it ultimately is able to sell to customers?

A. My understanding of the process there would go far beyond just the raw milk that they are receiving. A great deal of the value add there would be related to their proprietary ultra-filtration process that concentrates those -- those nonfat solids.

Q. Did you attempt at all to run just Fairlife's numbers, even separately, just to use as a comparison?

A. Fairlife's separate data is confidential and proprietary, and I am not going to discuss Fairlife's confidential information.

Q. Okay. Understood.

If you can take a look at Exhibit 112.

If we just look at the first page there,

Mr. Miltner had asked you -- I think he was using Exhibit -- I think it was 17, where you said you were familiar with the data, because you have been using -- is that the source of the data that you used to do your conversion to skim?

A. Yes. So I used -- yes. Charts 1 through 4 are -- 1 through 3 are from Exhibit 17, but on a skim basis, and then chart 4 would be the butterfat, just from Exhibit 17.

Q. Okay. And if we look at just the first three charts, there's not any occurrence in which any of the -- any of the data points that you graphed between 2021 and 2022, that they even touch the current standard; is that correct?

A. For -- yes. This data is for the orders as a whole, and none of -- they are all above the current skim formula factors.

Q. Okay. So for purposes of the graph, the current standards are functionally irrelevant, aren't they?

A. When you are looking at it for the order as a whole, I think it's important that -- the reason why I included the current formula factors and the proposed formula factors is so that we could understand how the real producer milk receipts compares to the formula factors. So, you know, I was trying to compare actual producer milk receipts to the current and proposed formula factors.

Q. Okay. And to the extent that that current standard is even tracked on there, these -- this graphing

shows that it is irrelevant for purposes of measuring where those components are today; is that right? It never even dips below it.

A. So if -- if you look at the order by order information, for the survey plants, you will see that it's much closer. And so, for example, I think, if we look at page 9, which is the protein for the Central order, you see that the survey group is, you know, just above the current level in the summer months.

Q. Okay. It gets -- it gets closer to it, but still doesn't even cross over --

A. It doesn't dip below here for -- for the survey group from Order 32 as a group.

Q. And if you look -- look at the overall blend, or we can stay even on page 9, it looks like with time, and what we were just looking at on Exhibit 17, with time, even with these seasonal changes that occur that you have -- that you have graphed on here, with time, we can see that the overall trend is that those components are continuing to move upward; is that right?

A. Yes, absolutely. Over the last 20 years the components, both butterfat as well as the skim components, have increased in the milk.

Q. And we know that, as you have noted here, that there is a seasonal effect on this. But would you agree that overall it's somewhat of a ratcheted system in that with the improvement of genetics and the dietary or nutritional feeding methods, that those components

continue to retain those trends of moving upward over time?

A. Yes. The components are moving up.

Q. Okay. And they are keeping that trend line going in that direction; is that right?

A. Yes. And I believe that Dr. Van Amburgh suggested that we should expect that they are going to continue to increase.

Q. And is that consistent with -- with the data that you have been tracking and monitoring as well?

A. You know, the data that I have been tracking and -- the data that I have looked most closely with is just this 24-month period. And so, you know, the sort of thing that you are -- that we're talking about right now is over a much longer period of time, so --

Q. Well, but you would agree that even on the 24-month period that you are tracking, we can see that that trend line continues to move up, even looking at that two-year period?

A. I wouldn't agree that -- in the two-year period, like what we can talk about is the seasonal change. But the two years, like, I wouldn't want to, like, run a regression through this and be, like, yeah, it tips up. I -- that's -- that -- that feels like a short period of time to me to be making a statement like that.

Q. Okay. But, for example, if we just looked at the first page of Exhibit 112, it looks like this, at least for the protein percentage by skim for the Federal Milk

Marketing Orders for this two-year period, you can see that if you compare the two time periods to similar months, from 2021 to 2022, that those move upward.

A. Indeed. Like, if you look at the Pacific Northwest for January of '21 relative to January '22, December '22, you are going to see them going up.

I would also say that, like, this is only 24 months. And the tail end there in November, December 2022, those are some pretty -- before I put a trend through this, I would want to see what happens in the first two quarters of 2023.

Q. And you can look back, at least with your familiarity with Exhibit 17, you can look back all the way to 2000 for that; is that right?

A. Yeah, I could. I have not done that work to date. Like I said, my focus has just been on these comparisons over this 24-month period.

Q. Okay.

MS. HANCOCK: Thank you for your time. Appreciate it.

THE WITNESS: Yep.

CROSS-EXAMINATION

BY MR. COVINGTON:

Q. Calvin Covington representing Southeast Milk.

Good afternoon, Ms. Keefe.

A. Good afternoon, Mr. Covington.

Q. I want to -- just a couple questions here regarding producer pricing.

And you are familiar with how minimum Federal Order prices are established in orders that are required to be paid producers?

A. Yes, I'm familiar with both classified -- the class prices that the processors have to pay, as well as the producer pricing, the uniform prices.

Q. Okay. Good. Thank you.

In Federal Milk Marketing Orders with multiple component pricing, each month the Market Administrator is going to announce a protein price per pound, a butterfat price per pound, an other solids price per pound, and also a producer price differential. And subject to location adjustments, they would be the minimum prices that a regulated handler would need to pay to producers.

Do you agree with that, if I'm summarizing that correctly?

A. Yes. And I would add that the butterfat price, the protein price, the other solids price, those prices are going to be the same across the whole country. They are not going to change.

Q. Right. Very -- yeah. Yes. The only thing that would change would be the producer price differential among the orders?

A. Among the orders, the PPD is going to change, and then everyone is going to be changing based on location.

Q. Yes.

And let's take, for example, one step further how it works. Assume I'm back being a dairy farmer, and I'm

producing milk of above average protein content. And -- and I'm located marketing my milk in a Federal Milk Marketing Order with multiple component pricing. And within the same location adjustment area, at about the same distance from my farm, I could sell my milk to a cheese plant that is regulated under a Federal Milk Marketing Order, or I could sell my milk to a fluid milk plant regulated under Federal Milk Marketing Order.

For one particular month, say, here the month of August, would the minimum price that that cheese plant had to pay me or that fluid milk plant had to pay me, would they be different or would they be the same?

A. So you are talking about the price paid to the producer irrespective of whether -- where the milk was shipped?

Q. Yes. Yes.

A. Yeah. So the minimum price to a producer is the same for -- irrespective of where the milk is shipped.

Q. Yeah. It is the same regardless where the milk is shipped, as long as it is in the same location adjustment and regardless of how the milk is used?

A. Uh-huh.

Q. Is that a basic premise of Federal Milk Marketing Orders for uniform pricing?

A. Yeah.

Q. Okay. Then is there any economic incentive for me, in that example that I used -- just used as a high protein producer, is there any economic incentive for me

to go to one plant over another?

A. At the minimum, definitely not.

Q. Okay.

A. That said, you know, you were just asking me about the regulated minimum price. You know, there -- that's not the be all and the end all of -- that's the base. That's like where we start with the prices. And so there could be premiums, there could be reasons why you might prefer one destination over another as a farmer.

Q. But either of those plants could pay me an over-order premium?

A. They could pay you an over-order premium based on your volume, but there could also be premiums based on your components.

Q. But you would agree, though, that here at this hearing, and Federal Order provisions, we're only involved in establishing minimum prices?

A. We are definitely only talking about minimum prices around here.

Q. So under Federal Order regulations, there's no economic incentive for me to go to one plant over the other, the Federal Order price is going to remain the same?

A. As your producer price is going to be the same.

Q. Okay. Then go back to your written statement, your written statement, Exhibit 111. And I'll wait until you pull that up.

On page 6, your last sentence there before you get

to the bold E, where you state that "suppliers are maximizing revenue by supplying higher component milk to manufacturing classes."

Again, going back to my example, again, using minimum Federal Order prices, can you explain to me then how I would get an advantage of my high protein milk going to a manufacturing plant when the Federal Order minimum prices are the same?

A. So what I'm talking about there is not the uniform prices, I'm talking about the class prices there, and whether the milk -- say, like, when a cooperative is marketing the milk, whether they would be better off selling the load to a fluid plant or to a cheese plant. And so I'm not talking about the producer prices there.

Q. Okay. Well, let's go back to my example. And I said I was a dairy farmer. Let's say I'm a cooperative. And as a cooperative, going to regulated plants, those regulated plants have to pay me the minimum Federal Order price.

So are you saying that if I'm a dairy farmer versus being a cooperative, then the minimum price would change?

A. The minimum producer price isn't going to change. I was talking about the classified prices that handlers pay in that paragraph. I was not talking about minimum producer pricing there.

Q. Okay. So -- so, again, suppliers, you don't refer then to a person that's supplying the milk. You consider

a person supplying the milk as being a supplier?

A. A supplier could be a cooperative. A supplier could be a producer. It could be a direct ship like Patrons. There's -- there's different ways that it happens in the industry.

Q. Okay.

A. But I -- like I said, this paragraph is about the classified prices paid by the processors as opposed to the uniform price paid to the producer.

Q. The classified prices that -- that are paid by the processors that were regulated under a Federal Milk Marketing Order, those classified prices, are they used for the particular regulated handler to make a settlement with the Market Administrator?

A. Absolutely.

Q. Okay. So if those prices, classified prices you referring to here, are used to settle with the Market Administrator, so, again, if I'm a dairy farmer or a cooperative, and I'm getting the minimum price that's paid to me, how do I gain, if I'm a high protein producer, going to a manufacturing class then under the order?

A. Can you repeat that question?

Q. Yes.

A. I'm a little lost.

Q. Be glad to.

We have already talked about that both a fluid milk plant or a cheese plant that's regulated, okay? Are going to pay producers or the cooperative -- consider

cooperative as a producer -- supplying milk to any of those plants the minimum price. In component pricing orders, there's going to be protein, other solids, butterfat, and the producer price differential, minimum -- and we agree to that; is that correct? Both plants would pay the same minimum producer price?

A. The minimum producer price is going to be the same. The classified prices that are going to be used for -- that are going to be put together and then used to determine the PPD, those are going to be different between the plants.

Q. So are you saying if I went to the manufacturing plant, I would receive a different producer price differential than going to the fluid milk plant?

A. No. I'm sorry, I think we're -- I feel like we're talking past each other a little bit. And maybe I'm just not following your -- the example that you are trying to get me to follow.

The PPD is going to be the same for all the producers in the order. Okay? So -- and then the uniform price is going to be the same for all the producers in the order. But if we have four plants in our order, and one is a -- one does I, plant two does II, plant three does III, and plant four is in Class IV, each of them is going to have a different classified price for their milk.

And so the Class I plant is going to be buying their milk on a butterfat skim basis. And then the Class II plant is going to be buying their milk with

typically butterfat and nonfat solids. And then the Class III plant is going to be buying their milk across all the components. And then the Class IV plant is going -- we're going to be back to like II with the butterfat and the solids.

And so then over here, on the producer side, we're going to have -- you're going to be paid out for your components. You are going to be paid for your butterfat, your protein, your other solids, then you are going to get the PPD, and then there's going to be location adjustments. And so -- and so my statement on page 6 of my written statement, my -- the paragraph there just above E, I was talking about classified pricing there. I was not talking about producer pricing.

Q. Okay. So suppliers there does not refer to a dairy farmer or a cooperative supplying any of those four different plants there then?

A. Suppliers does refer to the -- the suppliers are producers and cooperatives. The plants, the processors, are required to pay the minimum classified price. They have to pay those minimum class prices. And the pool hangs out here, in the middle, so that -- to equalize amongst these four different so that we get the one uniform price over here for the producers. And so there is no processor paying the uniform price. The processors buy and sell at class. And then -- and then we have the pool, and then the producers get the uniform.

Q. But as a supplier, can I get an economic advantage

at minimum prices paid under the order by going to one plant over another?

A. I believe in multiple component order, as a supplier, it is my view that you would be best off going to -- if you have high component milk, you are going to be best off going to, like, the cheese plant, where you are going to get paid out for those components.

Q. Okay. So if I went -- my milk went to a fluid plant that's regulated under multiple component pricing order, are you saying I'm not paid for my components, that the minimum order price is not components?

A. Who are we talking about right now? I'm sorry. I'm lost again.

Q. Okay. I'm a dairy farmer, marketing my milk under a Federal Milk Marketing Order.

A. Uh-huh.

Q. Okay. That uses multiple component pricing.

A. Okay.

Q. And I have an opportunity to sell my milk to two different regulated plants, one bottling fluid milk, one manufacturing cheese. Both of them are regulated.

Is my price as a producer any different regardless of which plant I go to?

A. Your producer, the uniform price, is going to be the same in both cases.

Q. So there's no economic advantage, me as a dairy farm supplier, of going to a fluid milk plant over a manufacturing plant at the minimum order prices?

A. The uniform price that the producer gets is the same whether -- no matter where they are shipping the milk to, assuming all their components and everything else are equal.

Q. In my example, one is a fluid plant, one is a cheese plant, I'm going to get the same minimum price?

A. The regulated minimum price is for the order. The regulated minimum price does not depend on any one plant's utilization.

Q. Okay. Again, no economic advantage going to one plant over another?

A. The regulated minimum price is the same all the time.

Q. Okay. If National Milk Producers Federation Proposal 1 was adopted, and we all agree that it would increase the Class I skim milk price, what -- what impact would that have on producer prices in multiple component pricing orders?

A. It would depend on the fluid milk, the Class I utilization in each one of those orders. So like with Mr. Miltner, he just reminded me of Peter Vitaliano's testimony last week with the -- I think it was $0.50 and $0.80, and we agreed that it was about $0.60 for Class I.

And so in an order that has very high Class I utilization, say, like, down in the Southeast, that's going to increase the uniform price more down there because the Class I utilization is higher. In an order that has very low Class I utilization, like the Upper

Midwest, it would have a very small impact on the uniform price.

Q. In multiple component pricing orders, if we increase the revenue coming in from skim milk, any change in revenue would show up in the producer price differential; is that correct?

A. Yes, it would.

Q. Okay. Thank you.

MR. COVINGTON: That's all I have, your Honor.

MS. HANCOCK: Your Honor, I just --

THE COURT: Ms. Hancock, I can't tell if someone -- it is not. Ms. Hancock.

MS. HANCOCK: I just have one brief question, if I may.

THE COURT: Yes.

CROSS-EXAMINATION

BY MS. HANCOCK:

Q. Ms. Keefe, if National Milk's Proposal Number 1 were recommended by the USDA to be implemented with the multiple components as proposed by National Milk, would MIG support the delayed implementation?

A. Yes. If the Department were to adopt Proposal 1 or Proposal 2, we would want to see the 12-month delayed implementation for risk management purposes.

MS. HANCOCK: Thank you.

CROSS-EXAMINATION

BY DR. CRYAN:

Q. Good afternoon. I'm Roger Cryan with the American

Farm Bureau Federation.

So I appreciated your analysis. I found a couple of things striking. The most striking thing I found about it was how well it demonstrates that these tests are all above the current standard, pretty clearly across the board.

MR. ENGLISH: Is that testimony or --

BY DR. CRYAN:

Q. Would you agree with that?

THE COURT: Yeah, I think it is testimony by Mr. Cryan. But I think you better put a question mark in there somewhere, Mr. Cryan.

BY DR. CRYAN:

Q. Would you agree with that Sally?

A. My analysis demonstrates that on the average, for the orders as a whole and for the survey group, that the -- that most -- that most of the tests are slightly above or -- the current level, and then -- but they are also mostly below the proposed level.

Q. Depending on which graph you are looking at, because there's some of these where it seems like the proposed level sort of cuts right through the middle of the line, it seems to me.

Does that -- does it seem like that to you?

A. It doesn't seem like that to me, that the proposal cuts right through the middle of it, no.

Q. So on Table -- on page 1, in Exhibit MIG-5A, it did -- I mean, the proposal is to -- is based on averages,

previous averages. And it is -- and the -- an average means that some will be below and some will be above. The -- again, on page 1, does that not show a line more or less going through the protein -- through the middle of the protein tests on your -- on your graph?

A. So the proposals are definitely based on averages. And I would point out, again, that we have a minimum regulated price system and that it's very important to consider the low points and the seasonal impact.

Q. Uh-huh.

A. And additionally, this -- the -- this information on the first chart is only for the seven multiple component orders for two years.

Q. Okay. Does it appear to you that there's an -- that your graphs generally show an upward trend from even over just the course of two years, from beginning to end, for these tests?

MR. ENGLISH: Asked and answered.

THE COURT: Yes, Mr. English?

MR. ENGLISH: That was a question asked by Ms. Hancock and --

(Court Reporter clarification.)

MR. ENGLISH: And so it's asked and answered. I mean, if we're going to keep asking the same questions, we're going to never get done with this hearing.

THE COURT: Well, my memory is not perfect. Unless Mr. Cryan admits that that's been asked and answered --

DR. CRYAN: I --
THE COURT: -- I'm going to allow it this time.
DR. CRYAN: Okay.
BY DR. CRYAN:
Q. So a yes or no is fine.
A. So as I was discussing with Ms. Hancock, this data, for example, on the first chart with the Pacific Northwest, Ms. Hancock and I went through some of that, and I noted that before I put a trend line through this data, I would want to see what was happening before and after. This is only a 24-month period.
Q. And it's a 24-month period that ends about nine months ago.
Do you have any indication that there's been a -- well, you said that you don't acknowledge a trend. Okay.
DR. CRYAN: I'm -- I think -- that's -- I'm done. Thank you very much. Thank you.
THE WITNESS: You're welcome.
THE COURT: Any further cross?
Seeing none, redirect?
MS. TAYLOR: AMS has some questions, your Honor.
THE COURT: I'm sorry. I'm going to do that the rest of the hearing, I can tell.
MS. TAYLOR: We don't mind. I do think --
THE COURT: I mind.
MS. TAYLOR: -- Mr. Wilson's going to start.
THE COURT: Yes, Mr. Wilson, your witness.
MR. WILSON: Thank you, your Honor.

CROSS-EXAMINATION

BY MR. WILSON:

Q. Todd Wilson, Dairy Programs.

Hello, Ms. Keefe.

A. Hi, Mr. Wilson.

Q. So I've been accused of being in the weeds sometimes, so I have got some questions relating to some of the things that you had in your testimony, as well as some of the information on the graphs.

Page 4, you indicate that the survey that you conducted was from the MA report receipts and utilization submissions, and then in the next paragraph, you talked about audited and reported. And then in the next sentence you talked about secondary data sources.

So could you go through maybe -- you know what those terms mean, so I would like for you to kind of talk to that.

A. Sure. So every month a handler submits a report of their receipts and their utilization, and that goes in to the Market Administrator. And then about a week later, or not even a week later, you turn it in on the 7th, and then on about the 10th, so a few days later, you get back your monthly statement of handler obligation.

Typically, the receipts and utilization on -- that you are reporting are going to match out to your statement of handler obligation unless something's been found at pool and that there's a -- you know, it could be that you fat-fingered something or whatever, and so there's been a

correction there, a difference between what you submitted and then what comes back. And then later in the process, usually a few months later, then all of that will go through audit, and there could be yet another correction phase.

And then as far as the secondary data that I was referring to, that would be like the plants, like, receiving records on their component tests on their producer milk at receiving. So this isn't like component testing that the plants are doing to check their composition standards for, you know, sale of finished goods. This is on, you know, raw milk in the silos type of stuff.

And there what I found in the data, particularly in the later part of the period where we weren't -- where we haven't necessarily -- that the plants haven't been through their audit yet, that there would be some things where it would be, like, there's a number here that doesn't make sense, like, can we try to get this right so that we don't have a total outlier and need to exclude the plant.

Q. So is it safe to say that the secondary data sources were used to validate information or could that information actually be in the data?

A. That it was used to validate, and then in a handful of instances, the secondary data source was used as opposed to the primary data source when it was clear that the primary data source had an error in it, that

based on my experience, a few of these plants in the survey will probably have an audit adjustment coming in their future.

Q. I would hope so.

The -- could you -- do you know approximately how much data you might have that had been audited?

A. Most of the plants were I -- and I believe that everybody was through the audit for the first six months of 2021. About half of them, it was all of 2021; about half of them, they weren't done with 2021 yet. And there may have even been a few that were into 2022. But it varied it -- it -- it varies. Like, it's not the same -- everybody's cycle isn't the same.

And, you know, typically, when the audits are completed, like they're doing multi- -- the Market Administrator offices are doing multi-month blocks at a time, and so like you could have a plant in Order 32 that has 12 months of audited data, but there might be another one that has nine and one with 15. Like, that is the sort of stuff that I was seeing.

Q. And so the submitted information, is it fair to say that that was from the obligation report that comes back from the Market Administrator?

A. Yes.

Q. Okay.

A. Yeah.

Q. Thank you.

Continuing on to -- so on pages toward the end of

your testimony, you went into the -- your charts, I believe, that you have made. You have converted -- you have converted the test of protein, other solids, and solids nonfat back to a skim portion, skim milk.

Did you -- can you go through that calculation for me?

A. Sure. So probably the easiest way to look at that would be in my testimony. If we look at the table on page 3, which is skim, versus the table on page 4, which is milk. If you -- so -- so the current nonfat solids on a milk basis is 8.69, when you still have 3.5% butterfat. And then the page before on page 3, if you have got no butterfat left -- and I would point out that this is formula butterfat, I have not met a separator yet that gets it down to zero -- that then we would be at 9% on a skim basis. And so the amount in the milk there is the same between the table on page 3 of my statement and the table on page 4. It's like the sort of --

Q. So in your graphs you have -- you have -- instead of taking 3.5% butterfat out of producer milk, you took out the pounds of fat or the test of fat in producer milk to get back to skim?

A. Can you repeat that, Todd --

Q. So --

A. -- Mr. Wilson?

Q. -- on page 1 of your 28-graph page of MIG-5A, that's on a skim basis?

A. Uh-huh.

Q. So the protein there, you -- you have removed the fat --
A. Yes.
Q. -- from the pounds to compute a protein percent?
A. Yes. On a skim basis.
Q. On a skim basis?
A. And I removed all of the fat. Like, formula -- formula skim, perfectly zero.
Q. And I'm not sure -- we were kind of looking at our graphs that were submitted through USDA, and there seemed to be one in the submission that somehow was missing a line. It's on --it's on the printed copy, but I --
A. Oh, really?
Q. -- just wanted to make a point of that, maybe to clarify that. I think it was on page 17, if I remember right. Yeah. So page 17, the 124 survey line did not show up on the -- on the graph.
A. So the -- so you are saying that the -- on page 17, the blue survey line isn't showing up in the PDF?
Q. Correct.
A. Okay.
Q. On the website.
A. That's weird.
MR. ENGLISH: Can I look?
Your Honor, obviously we submitted -- the papers copy have it, correct?
MS. TAYLOR: Yes.
MR. WILSON: Yes, the paper copies --

MR. ENGLISH: So it's only the website?

MR. WILSON: Yes.

MR. ENGLISH: So we will obviously resubmit as soon as we can figure out why it is that something loaded that shouldn't have loaded.

THE COURT: Thank you.

THE WITNESS: That's strange.

MR. ENGLISH: Technology.

MR. WILSON: Usually it is because I have got a different OS, but I don't think that's the case this time.

BY MR. WILSON:

Q. So on page 25 of those charts, you have got 32 plants in your survey. That equates out to 768 data points.

In -- the prior witness from Shehadey testified to the number of occurrences that was either above or below.

A. Yeah.

Q. Is there a way that you would be able to provide us in these -- these stacked bar graphs, the number of occurrences over the -- over the 24-month period that was above and below?

A. Yes, I'd be happy to do that. So you are talking about putting the data labels on the bars?

So like, for example, for, like, on page 25, like showing -- if we look at June of 2021, we have got 31 below and one above. That sort of information?

Q. As just a combined number of -- out of the 768 occurrences.

A. Yeah. I'd be happy to do that.
Q. I have also been told that page 19 might need to be looked at as well on the website submission.
A. Okay.
MR. WILSON: That's all I have, your Honor.
THE COURT: Ms. Taylor?
THE WITNESS: Ms. Taylor, can we wait for just one moment while I write down the page 19?
MS. TAYLOR: Certainly. Of course.
THE WITNESS: Mr. Wilson or Ms. Taylor, do either of you know which is the one that isn't coming through on the PDF as opposed to the print?
MR. WILSON: It's the PR survey.
MS. TAYLOR: The PR survey.
MR. WILSON: It would be the blue.
MS. TAYLOR: The blue line.
THE WITNESS: Okay.
THE COURT: Should we go off the record and talk about it?
MS. TAYLOR: We'll figure it out.
MR. ENGLISH: There's no way I will figure out how that happened. Obviously, you know, all I can tell you is we loaded the PDF, but we will -- we're here right now. We can't load it again right this second. But we assure you we will figure this out, although somebody else will figure it out than me.
THE WITNESS: I'm going to be honest, somebody else other than me maybe will figure this out, because I

sent the print job from the same PDF, and so why once it goes through the website the line disappears, I'm really perplexed.

MR. WILSON: I bet somebody's already figured it out. It's only been three minutes ago.

I do have a couple more. I'm sorry, your Honor.

THE COURT: I'm not sorry. No reason for you to be sorry.

MR. ENGLISH: All I can say is our person on the ground says what we sent -- looking at what we sent to USDA has the line. So somehow between getting it to you and getting it posted, which -- that's a technology issue.

MS. TAYLOR: Yeah. That might be an accessibility issue that happened, so let us check into that. We have to convert them when we get them to be able to put them on our website --

MR. ENGLISH: So it could be a conversion --

MS. TAYLOR: -- and it might have been a conversion --

MR. ENGLISH: Before we resend, we'll work together to fix this.

MS. TAYLOR: No problem.

THE COURT: Off the record a second.

(Off-the-record.)

THE COURT: Back on the record.

BY MR. WILSON:

Q. So page 28.

A. Okay.

Q. That's the last page listing of MIG IDFA fluid plant -- fluid survey plants.

A. Uh-huh.

Q. The Federal Order column, is that an indication of if it's regulated or not or --

A. It's -- it's generally which -- which Federal Order the plant is reporting -- reporting to. There is one plant that -- Danone's plant in Mount Crawford, Virginia, typically reports to 5. They are a partially regulated plant. Sometimes they are fully regulated, and when they are fully regulated, they are typically fully regulated on 1. And so I included them at -- on 1.

Q. Okay. So sometimes that plant might be fully regulated on 1; some -- sometimes it might be a partially regulated plant. So there is -- there are partially regulated plants in this listing as well?

A. Yep. Yes, there are.

Q. Could I also point out, about a third of the way down, Kroger, Winchester, Kentucky, Order 5. You have that listed in the butterfat protein other solids column.

A. Yes. So Kroger at their Winchester, Kentucky, plant, that -- so they get my data gold star award. So lest anyone think from the earlier conversation that -- that the Kroger plants were not -- were having data problems, like some of them were, some of them weren't. But Winchester, Kentucky, is on Order 5, which is a butterfat skim order. And they actually had records for their butterfat protein and other solids, and they were

able to show me that the butterfat in these records was a match for their -- the information that they were reporting on their butterfat skim report for -- that they report to Order 5.

Because you're quite right, the other Order 5 plants did not have that and then -- and that's not uniform across Kroger, like you can see. Like, Kroger in the Murfreesboro, Tennessee, that's a butterfat only available, and so -- but that plant in Winchester, Kentucky, had it available.

And, likewise, I would also point out that Mount Crawford, Mount Crawford reports to Order 5, but then when they are pooled, they are pooled on Order 1, and so they have all the data all the time for the components.

Q. Okay. So to follow that line of thought through the graphs. Is the data from Mount Crawford --

A. Uh-huh.

Q. -- is it listed in the Order 1 and subsequent data points for components?

A. Yes. So like the Order 1 -- so Mount Crawford would be part of the -- would be one of the data points in the Order 1 graphs, and then -- and then Mount Crawford would also be in the group of graphs that are the -- all the MCP together. And then the bar charts at the end with the above and the below.

Q. And for Kroger Winchester, for the stacked bar that you just mentioned, are -- is Winchester going to be --

A. Winchester will be one of the 32 plants in the -- in the stacked bar chart.

Q. And if I --

A. Sorry. And that's Kroger in Winchester, Kentucky. There is another Winchester in here, so it can get confusing quickly.

Q. Yes. And that one's actually Order 1?

A. Yes.

Q. Thank you for that clarification.

MR. WILSON: That's all I have, your Honor.

CROSS-EXAMINATION

BY MS. TAYLOR:

Q. Good afternoon.

A. Good afternoon.

Q. I have a few non-weedy questions, as I like to call them.

You spoke about the difficulty that MIG members face when they need to attempt to pass along monthly Federal Order cost variations to their customers.

Do you know if MIG members utilize any risk management tools to help them hedge that risk?

A. Some do and some do not, so -- and I expect that the members will be attending subsequent later in the hearing and will be speaking to that directly.

Q. Okay. And then one of the sentences Mr. Miltner asked you about was on the end of your statement, page 7, about "raising Class I prices based on components would be taking more money from Class I that it cannot recover in

the market."

And if I remember your answer correctly, it had -- that you specified your discussion about basically milk in California has to meet those fortification standards, and what I took from that is if a handler in California has to -- has extra milk that they can't sell in the state, and maybe they try to sell it elsewhere, they are unable to recoup that additional fortification cost.

A. Generally, yes, that's -- yeah.

Q. Is that phenomenon seen anywhere else outside of those California handlers?

A. With respect to this particular issue, I -- I don't think so. I mean, it's very -- it is a very California specific thing.

Q. Okay. Would you agree or disagree that one objectives of the Federal Order system is to create uniform raw milk costs between similarly situated handlers?

A. Yes. It's my view that the -- that the system is designed to create uniform regulated minimum, so, like, the regulated minimum at the bottom, at the floor.

Q. And then that would allow the handlers to compete on other competitive factors in the marketplace?

A. Yes. Other competitive factors in the marketplace above the minimum.

Q. Correct. Okay.

And so in -- I'm going to ask a question I have asked of other witnesses, a similar question. So if all

fluid milk processors face the same regulatory change on their raw milk costs, how does this -- or does this change the competitive relationship between those plants when it comes to that -- those raw milk costs?

A. When it comes to those raw milk costs in the regulated minimum price, they would be similarly situated.

I would point out that there is a wide variety of different types of processors in our industry today, so you have proprietary bottlers. You have the captive bottlers that are owned by a retailer. You have the cooperative bottlers. There's a -- there's a wide variety. And so, you know, the way those competitive relationships between the different types of bottlers out there, I think that there is -- that there are nuances there that are probably -- that need to be considered.

Q. Okay. And then if I could sum up what I have heard over the past few days of MIG's primary objections to adoption of Proposal 1 or 2, I think the first objection as I have heard it is that higher component levels -- I don't know the right word to use -- but really aren't of importance to Class I handlers because they sell on a volume basis, not on a component basis, so getting additional components above a certain level of minimum components is -- is -- it doesn't really matter to them.

Would that be correct as one objection to those proposals?

A. Yes, that's correct.

Q. And then as I have heard it, the second objection

would be that the levels proposed in Proposals 1 and 2 far exceed the actual component levels of milk received by fluid plants owned by MIG members.

A. That's correct.

Q. Okay. So I know USDA put on data into the record on Federal Order component averages for pooled milk.

So if we had the ability to look at audited component data for milk delivered specifically to fluid milk handlers, would using those component averages better reflect what your plants actually received rather than Federal Order pooled milk averages?

A. That sort of an average would definitely better reflect it. I also think that we should be thinking hard and looking at whether it should be an average or the minimum.

Q. Can you just expand on that a little more for the record?

A. Sure. What I mean by that is that we have a minimum regulated price system, and so rather than setting those component factors at the -- at the average, and so if we were doing that at the average, like, maybe we should be talking about raising the 3.5 and the reference price to a higher number, and because butterfat also no longer averages 3.5.

And so, to me, it would make a lot of sense to think about the minimum levels that are out there being received by fluid plants.

And certainly one very real problem with the

average is the seasonal nature of all of this, and that you have got this high in the winter, low in the summer thing going on that is another real kind of picky issue to try to, like, wrap your head around that math and those pricing implications as well.

Q. Okay. And so taking the discussion of averages one step further in your -- MIG's concern about using averages. I mean, would that extend to other factors we may be considering later in the hearing on pricing formulas that might look at an average of some data series that's put on instead of a min or a max number?

A. So I'm -- I think that -- I think that it's a little bit different here on the -- not all the stuff that's being considered here in the hearing is exactly the same as the -- when it goes through the formulas. And, you know, it's, frankly, much like the question that Ms. Hancock asked me, and Mr. English asked Mr. Gallagher, about the skim formula factors and the impact on risk management with the 12-month -- with needing to have a lag for risk management.

This part of the formula is what you're actually buying. It's like the real -- it's -- it's the quantity part of what's going on. Whereas other parts of the formula, say, like, a manufacturing cost survey or something like that, to me at least, that's a little bit different. Like, that is -- that is talking -- that's -- that algebra that we need to go through in our end product price formula system to go from the commodity price to get

to the milk price. And so I don't think that this whole thing of minimums versus averages is a one-size-fits-all sort of situation. But to be fair, there are other places where I think that the minimum is more appropriate than the average.

Q. Make me beg the question, an example of one?

A. So coming up in later issues, I am confident that you will hear from me on my views about minimums and averages. So -- we can save that for another afternoon.

Q. I'll save that for further conversation.

MS. TAYLOR: I think that's it. Thank you so much.

THE WITNESS: You're welcome.

THE COURT: It's 3:22. Do we have redirect?

MR. ENGLISH: I do but --

THE COURT: How long, Mr. English, do you think?

MR. ENGLISH: I don't know how long, but I -- I need a break.

THE COURT: I'm sorry, you need a break? I need a break.

Let's come back -- let's come back at 25 of. Let's come back at 3:35.

(Whereupon, a break was taken.)

THE COURT: Back on the record.

Mr. English, you have redirect.

MR. ENGLISH: It will be very short, I hope, your Honor.

///

REDIRECT EXAMINATION

BY MR. ENGLISH:

Q. So, Ms. Keefe, Mr. Miltner asked you a couple questions about organic milk.

A. Yes.

Q. And I just wanted to clarify for the record because I got a little confused about what was asked and what was answered.

So organic milk, by and large, is priced on long-term fixed price contracts, prices significantly higher than the Federal Orders, correct?

A. Yes. Typically organic milk is bought and sold at -- on a long-term fixed price contract, at prices that are substantially above the Federal Order class prices, and those prices are generally not tied in any way to the class prices.

Q. So if Proposal 1 -- or for that matter, any other proposal in this hearing later, is considered and adopted which raises the Class I price, what is the practical impact for an organic handler?

A. The practical impact for an organic handler would be a change in -- for the proposals that you just asked about, an increase in their pool obligation, so it changes their fully landed cost of milk. So it's -- you know, the cost of getting the milk off the farm, to the plant, the cost of the milk itself, the regulatory costs, in this case the pool obligation on the milk. It wouldn't change the actual price paid for the milk itself under the fixed

price long-term contract.

MR. ENGLISH: That's all I have, your Honor.

THE COURT: Any further questions?

Yeah, let's go ahead and put these --

MR. ENGLISH: I move admission of Exhibits 111 and 112, your Honor.

THE COURT: Objections?

Exhibits 111 and 112 are made a part of this hearing record.

(Thereafter, Exhibit Numbers 111 and 112 were received into evidence.)

MR. ENGLISH: Ms. Keefe ended up with a number of documents that were provided to her that I believe belong to USDA, and we obviously want to make sure they get back to USDA.

MS. TAYLOR: Yes.

MR. ROSENBAUM: Your Honor, Steve Rosenbaum for the International Dairy Foods Association. We would like to call as our next witness, Mr. Steve Galbraith.

THE COURT: Yes. Raise your right hand.

STEVE GALBRAITH,

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

THE COURT: Your witness, Mr. Rosenbaum.

MR. ROSENBAUM: Your Honor, we have distributed an exhibit which is Mr. Galbraith's written testimony as IDFA Exhibit 24. We would ask that it be marked as Hearing Exhibit 113.

THE COURT: So marked for identification.

(Thereafter, Exhibit Number 113 was marked for identification.)

DIRECT EXAMINATION

BY MR. ROSENBAUM:

Q. Mr. Galbraith, could you start by telling us what your job title is?

A. I am currently vice president of procurement and commodity risk management for Saputo USA. I work out of the Dallas office at 2711 North Haskell.

Q. Okay. Before we get into your reading your testimony, which has been distributed in hard copy and was posted to the website as well, I understand that you have a small correction to make to the table that appears attached to your testimony. So why don't we go ahead and do that before we have you start your testimony.

A. So on the Excel spreadsheet, pardon my fat fingers, the boxes at the bottom should read, the averages for 2022, the bottom should be 9.1391, and the one below that for the total of the 19 months should be 9.1327.

Q. All right. So just to be clear, there's a number that right now is 9.1070, and that should be changed to 1-point -- excuse me -- should be changed to 9.1391; is that correct?

A. Correct.

Q. And then there's another figure that's 9.1212, and that should be 9.1327?

A. Correct.

Q. Okay. All right. Could you please read your testimony?

A. Sorry. My background?

Q. Yes, please.

A. Well, I'm Steve Galbraith, as I mentioned, vice president of procurement and commodity risk management at Saputo Cheese. I have held this position since April of 2013. I'm located at the Dallas office on North Haskell.

Saputo operates 29 plants in 13 states across the United States, manufacturing and packaging a variety of cheese, cultured dairy products, whey ingredients, extended shelf life, and aseptic dairy products.

Saputo is among the top three cheese manufacturers and one of the largest producers of extended shelf life fluid products.

22 of the 29 plants in the United States process milk and receive milk pooled in seven different Federal Marketing Orders. Most of the milk we buy is regulated by Federal Order system and extends, at least to some degree, of all classes of milk.

We frequently source milk, cream, and condensed dairy products from ten of the 11 Federal Marketing Orders as well as unregulated regions of the Western United States. Consequently, Saputo does have a strong interest in the decision resulting from this hearing.

A little bit about my background. As vice president of procurement and commodity risk management at Saputo, my primary responsibilities involve negotiating

contracts for the purchase and delivery of dairy commodities for the Class II manufacturing facilities --

(Court Reporter clarification.)

THE WITNESS: So my primary responsibility is in negotiation of contracts and purchase and delivery of dairy commodities for the Class II manufacturing facilities, as well as administration of commodity risk management programs for all of Saputo USA.

Prior to my experience at Saputo, I spent nine years as VP of procurement in the White Wave, Morningstar, and Corporate Divisions of Dean Foods, and I started my procurement career at Nestle USA where I spent my entire 15-year tenure in the procurement group, working most of the time on the commodity procurement and risk management teams. In the last five years at Nestle I held the position of VP of commodity procurement and risk management for dairy, fats, and oils, and sweeteners, at Nestle.

I also serve as president of the California Creamery Operators Association.

I grew up in Eastern Kansas on a farm, although not a dairy farm, and I graduated from Kansas State University, with undergraduate degrees in animal science and business.

So I have spent most of the last 55 years of my life working in agriculture for some -- at some extent, and the last 25 years heavily focused in the dairy sector. That's the background.

So I think the position that we would have regarding -- we have reviewed and support the testimony of Mr. Mike Brown representing the International Dairy Foods Association. And I want to -- specifically want to testify on Proposals 1 and Proposals 2.

BY MR. ROSENBAUM:

Q. All right. And just so we have it on the record, is it your understanding that Proposals 1 and 2 would raise the current protein assumption in the milk composition formula from 3.1% to 3.39%?

A. That is correct.

Q. And the other solids would be raised from 5.90% to 6.02%?

A. Correct.

Q. And the nonfat solids, total nonfat solids, would be increased from 9% to 9.41%; is that correct?

A. That is correct. That is my understanding.

Q. With that orientation, could you please continue with your testimony?

A. So that proposal, which would update the milk component factors in the skim milk, should be rejected and is opposed by Saputo for the following reasons.

The raw milk components delivered to the Saputo plants in Federal Marketing Orders Number 6 and Number 7 do not support the component values submitted by the USDA as part of these hearings.

Q. So let me just interrupt you right there, because I want to get into that data.

Are -- are Orders 6 and 7 so-called fat/skim orders?

A. Yes, they are.

Q. Okay. If we can turn then to the table that's attached to your testimony, the one that you made the small correction on a little bit ago, tell us -- tell us what information -- it spreads on pages 4 and 5 --

A. Right.

Q. -- of this document. So tell us what it is your you're reporting here.

A. So what I'm reporting is the tests for skim solids and butterfat for -- in three of our plants, in Decatur, Alabama, Murray, Kentucky, and Plant City, Florida. And I went back and asked the QA managers at each plant to pull the records on the loads of milk that came in from January of 2022 through July of '23, and summarized the solids nonfat component as well as the butterfat component, summarized that on this sheet, and came up with averages across Florida, Alabama, and Kentucky.

Q. Okay. So these are -- the data here runs, I believe, in all -- in all cases, from January through December of 2022, and then also from January through July of 2023; is that correct?

A. That is correct.

Q. So this is basically the most recent 18 months of data that's available?

A. Correct. 19 months, correct.

Q. 19 months. I stand corrected. Thank you.

And if we look in the two boxes at the bottom of page 4, is the top box the data for calendar year 2022?

A. Correct.

Q. And is the bottom box the data for the first seven months of 2023?

A. No, it is an average of the entire 19 months.

Q. I stand corrected. Thank you.

And so what was the total of skim solids in 2022?

A. The average skim solids as a percent of raw milk was 8.78%, and as a percent of skim milk was 9.1391.

Q. All right. And just to lay this, if you will, upside, the Proposal 1 for these three plants combined for 2022, the average total skim solids was 9.1391%, correct?

A. As a percent of skim, correct.

Q. And if Proposal 1 were to be adopted, am I correct in understanding that Saputo would be required to pay for that milk as if it had total skim solids of 9.4%?

A. Correct. In those three plants.

Q. Okay. And then if we look at the bottom box, which as you have explained reflects averages for the entire 19 months covered by your tables --

A. Right.

Q. -- for those three plants, your total skim solids on a skim milk basis is 9.1327%, correct?

A. Correct.

Q. And, once again, if Proposal 1 were to be adopted, Saputo would be required to pay for that milk as if it contained 9.4% nonfat solids; is that correct?

A. Correct. That's my understanding.
Q. And is that something you think is appropriate?
A. No. And the reason it is not appropriate is -- and the reason we measure these solids is because we formulate certain levels of solids nonfat in our finished product. So what we have to do then is bring the fluid milk in, we know what the solids are, and then we fortify it with either condensed, skim, or with powder. So we would in essence have to pay for the solids twice.
Q. And you would pay for the solids once because you would be required to account to the pool as if the milk had 9.4% nonfat solids, correct?
A. Correct.
Q. And then you would actually have to go out to the marketplace and buy solids to make that up?
A. Correct.
Q. And that's what you mean by paying for it twice?
A. We would have to pay the delta between the 9.1 and the 9.4. That gap, we would have to backfill and pay for it again.
Q. Okay. Could you turn to page 2 -- I know I interrupted you when you were reading, but I thought it was important to -- to go ahead and look at the attachment the first time you referred to it. I think it was the -- I think we've sort of gotten through the first bullet point under number one. So if you could continue on, please.
A. So on many of the products that are classified as

Class II necessitate minimum levels of nonfat solids to meet the standard of identity. An example of that would be ice cream mix. And to meet these standards of identity, as I mentioned, we would have to go out and purchase either condensed skim or we'd use powdered milk to make up for that difference in the formulas to meet those minimum standard requirements.

And so in order -- and basically receive raw milk that has the pricing formula built in, which is -- does not adequately reflect the component values. It's simply paying for milk solids that do not exist. I call those ghost solids. That's my term. It's an unofficial term within the industry.

And the subsequent purchase of condensed skim to meet product requirements that are replacing those ghost solids is simply paying for the skim solids twice. And what that does is, it means that those plants in -- in Kentucky and Alabama and Florida now have a competitive disadvantage because they are paying for the solids twice as opposed to solids that are in the component priced orders.

Q. Because of the component price order, you actually only pay for how much solids are really there?

A. That is correct.

Q. Okay. If you could continue, please.

A. So the products that we fortify in our plants are ice cream mix, frappe mix, aerosol whipped topping, and we do do some specialty milks for California in our Murray,

Kentucky, facility that we have to standardize to California standards, and so we end up having to pay for that twice as well.

So those are the four big categories that we -- that we formulate skim solids for and put extra solids in, and the delta between the 9.1 and the 9.4 was just that gap I'm talking about that we would have to double pay for.

So we would not support Proposal 1, and for the same reasons, we would not support Proposal 2.

Q. And I think on the very last page you indicate you would support these becoming multiple component prices?

A. Yes. Absolutely.

Q. So meaning you are happy to pay for whatever solids are actually there, you just don't want to pay for what's not there?

A. Right. And paying for the solids that are there drives productivity and efficiency, and it promotes the farm and the plant operations. So I would definitely support the component pricing.

MR. ROSENBAUM: Your Honor, the witness is available for cross-examination.

THE COURT: Okay.

Who has cross?

CROSS-EXAMINATION

BY MR. MILTNER:

Q. Good afternoon, Mr. Galbraith.

A. Good afternoon.

Q. My name is Ryan Miltner. I represent Select Milk Producers.

I don't have very many questions, but I do have one. In your role as the vice president of procurement, you say that your responsibilities involve negotiating contracts for the purchase and delivery of dairy commodities.

Does that include raw milk contracts to supply your plants?

A. No. The raw milk contracts are purchased in another group that buys cheese, so that would be a different group. It would be the cream, condensed, condensed whey, condensed buttermilk, and commodity risk management.

Q. Are you familiar with the raw milk supply agreements for Saputo?

A. Somewhat, yes.

Q. Do you know if those contracts include specifications for a minimum level of butterfat in the milk that's delivered?

A. No, I -- I do not believe that -- I don't believe they do.

Q. Do you -- do you know if they have terms that include a minimum level of protein or other milk solids?

A. No. They do not. I do not believe they do.

Q. Okay. Do you -- do you know why they do not include those terms?

A. We don't pay for -- we don't need the protein in

the formulation. We -- in a Class II product, the protein is not something that we add the value to the customer within a Class II product, so we don't pay additional premiums for the protein. We do in the cheese but not in the Class II.

Q. Explain, if you could -- I'm looking at page 2 of your statement, where you list several products fortified or standardized with solids nonfat.

A. Yes.

Q. Could you explain the relevance of that to the issue with Proposal 1 and 2 if you could?

A. So when we bring -- when milk comes into our facility and we pay the Class -- the proposed Class II 9.41, and we are receiving less than that, then we have -- and we have to fortify on top of that, then what happens is we end up double paying for that. We have to add skim solids back to those products to meet standard of identities and/or performance issues that we have within those products, and in order to do that, we have -- we do buy other solids and fortify that.

Q. And are you suggesting that Proposal 1 will cause that to occur more often or increase the cost to Saputo, either one of those?

A. It will increase the cost.

Q. Would that cost be mitigated if you required your raw milk to have a certain level of other solids in it?

A. Yes, it would be.

Q. But Saputo you say does not do that today?

A. Not today.
Q. There's nothing that prevents them from doing that, though, is there?
A. No.
MR. MILTNER: Thank you.
THE COURT: Other than AMS, does anyone else have cross?
Seeing none, AMS, do you have cross for this witness?
MR. WILSON: Yes, your Honor.

CROSS-EXAMINATION

BY MR. WILSON:
Q. Todd Wilson, Dairy Programs.
Good morning -- or good afternoon --
A. It's good evening.
Q. -- Mr. Galbraith. It seems like I want to be back in the morning, maybe. I don't know why. Maybe tomorrow morning.
So as you are aware -- maybe, maybe not -- USDA identifies -- or Small Business Administration identifies companies for determination of small business, that is -- how many employees does Saputo have, estimated?
A. Twenty- -- worldwide?
Q. Yes.
A. 20,000.
Q. Thank you.
The information you have provided indicates that your -- on page 2, there's a couple of terms, and I just

want to better understand the testimony. There's a group of bullet points under products fortified/standardized with solids nonfat.

A. Yes.

Q. What does LFM indicate?

A. Lactose-free milk.

Q. Thank you.

Under number two right below that you indicate NMPF Proposal 2. Are you referring to NMPF Proposal 1 or NAJ Proposal 2 or possibly something different?

A. I'm referring to Proposal 2, which is the annual milk component factors update annually.

Q. Okay. Thank you.

A. That's what I'm referring to.

Q. On a previous witness we heard from, indicated plants in a USDA exhibit -- I don't remember what number it is, but it's a long list of plant names, and whether or not they are regulated and non-regulated plants.

You have identified two plants that you have and given information on, Decatur, Alabama, and Murray, Kentucky, and Plant City, Florida.

A. Yes.

Q. Can you identify if -- if any of those are fully regulated plants or not?

A. They are partially-regulated plants.

Q. Partially-regulated plants. Okay.

Is the Sulphur Springs plant partially regulated?

A. It is fully regulated.

Q. It's fully regulated. It wasn't highlighted in a different color, and I missed that.

A. I just use that as a reference point since it sits in East Texas close to Louisiana. It's still in Order 126.

Q. Yes. Thank you.

We've heard from a few different witnesses about risk management. I noticed in your background information that was one of the -- one of the things that is listed as your experience with.

Can you tell us if Saputo utilizes risk management tools in their -- in their risk assessment?

A. Yes, we do.

Q. Thank you.

Can you -- when you say "yes," can you expand a little bit on what type of products you might use? We have had several testimonies -- witnesses' testimony on CME or LGM Dairy.

A. We use both OTC, over-the-counter instruments, as well as exchange traded financial instruments on the CME, depending on what commodity and what product and what we're doing.

Q. Very good. Thank you very much.

MR. WILSON: That's all, your Honor.

THE COURT: Ms. Taylor, do you something?

MS. TAYLOR: No, that's it. Thank you.

THE COURT: Okay. Is that it for -- no one opened the door, I don't think?

Mr. Rosenbaum.

MR. ROSENBAUM: I just have a follow-up question or two regarding the questions you got from Mr. Miltner.

REDIRECT EXAMINATION

BY MR. ROSENBAUM:

Q. You were asked whether you could contractually demand that your dairy farmers provide higher nonfat solids milk, correct?

A. We can, yes.

Q. He asked that --

A. He asked that question, yes.

Q. And based upon who is supplying you with milk now, are they capable of doing that at this point in time?

A. We would have to have a conversation with them and see if they are. We haven't had that conversation, but we could have that.

Q. But based upon what they are supplying you so far, they're a considerable distance below 9.4%; is that right?

A. The evidence would indicate that they are not able to ship that.

MR. ROSENBAUM: Thank you very much.

THE COURT: Well, let's offer Exhibit 113 for identification into evidence, if that's fine with you, Mr. Rosenbaum.

MR. ROSENBAUM: So moved.

THE COURT: Seeing no objection, it is in the record. Thank you.

(Thereafter, Exhibit Number 113 was received

into evidence.)

THE COURT: You may step down.

THE WITNESS: Thank you.

THE COURT: Mr. Galbraith, thank you for coming.

MR. ENGLISH: I believe that we are sort of moving on to Issue 2. I just want to say that -- I know this -- I think this has been discussed before, but I want to make sure the record is clear. There will be -- unlike yesterday's witnesses, who hopefully will have follow-up from HP Hood and Shehadey -- there will be other MIG members who will testify later in the hearing, and their testimony will touch on Issue 1. So I just want to make sure -- you know, we're moving on to Issue 2, but I think we have talked all along about the fact that somebody may end up talking about an issue at another time. So I just want to make sure that's clear for the record.

THE COURT: Anyone else have anything they want to say about that?

I guess they'll object if they have a problem then, but it sounds like general agreement within the room since no one -- no one objected.

Okay. Are we -- are we going to keep going today or -- I thought so.

Ms. Hancock.

THE COURT: Raise your right hand.

PETER VITALIANO,

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

THE COURT: Welcome back.

THE WITNESS: Thank you, your Honor.

MS. HANCOCK: I don't know if this is the first time we're putting on a witness previously -- or that had previously testified. Do you want us to do the same, address, and name for the record?

THE COURT: Anyone see a need for that? I don't. It's all in the record.

MS. HANCOCK: Okay.

THE COURT: If you wanted to remind us -- I know we like to say things out loud rather than just do it on the paper. But I'm not going to interrupt you if you wanted to remind us of why this witness is qualified to testify. But I'm sure you asked before whether he was qualified to come, you can do that. But when you asked if he was qualified to testify as an expert, did you cover all the topics do you think?

MS. HANCOCK: Okay. Thank you.

THE COURT: Did you? I mean I may have already found that, so --

MS. HANCOCK: Yeah.

DIRECT EXAMINATION

BY MS. HANCOCK:

Q. Okay. Good afternoon, Dr. Vitaliano. This is your second round at testifying at this hearing; is that right?

A. That is correct.

Q. And this testimony that you are offering today,

what is the topic on which you will be talking?

A. My testimony today is in support of Proposal 3, one of five proposals submitted by the National Milk Producers Federation, hereafter known as NMPF.

Q. Okay. And just so our record is clear, you previously in this hearing have been qualified as an expert. I'll just note that here for this portion of the transcript. So if there's any question, it at least creates an anchor point to refer back to day one of testimony.

A. Very good.

Q. And did you prepare a statement on behalf of your testimony in support of barrel elimination?

A. I have.

Q. And is that what's been identified as Exhibit National -- or excuse me -- Exhibit NMPF-6?

A. It has.

MS. HANCOCK: Your Honor, I'd ask that this be marked as the next exhibit for identification purposes.

THE COURT: So marked.

MS. HANCOCK: I don't recall what the number is.

THE COURT: I'm sorry, 114.

(Thereafter, Exhibit Number 114 was marked for identification.)

MS. HANCOCK: 114. Thank you.

BY MS. HANCOCK:

Q. Dr. Vitaliano, would you mind presenting your testimony as outlined in Exhibit 114?

A. Yes. I am Peter Vitaliano, vice president of economic policy and market research at National Milk Producers Federation. This testimony is presented in support of Proposal 3, one of five proposals submitted by National Milk Producers Federation.

I am going to summarize parts of my testimony. Those are the parts that are identical to the -- my testimony a week ago, and it was just one week ago, although it may seem longer to some of us.

The parts that I want to summarize concern description of the National Milk Producers Federation; a background of Federal Order Reform emphasizing the very important transition in Federal Order Reform from the direct survey of milk prices to the indirect price discovery of milk prices through the end product price markets, through a combination of formulas that translate those product prices into a raw milk price; the importance of those formulas to mirror closely the structure of the U.S. dairy industry that guides that transformation; the fact that the product price formulas adopted in Federal Order Reform contain mostly fixed factors that have largely not changed since the time of Federal Order Reform, contrasted to the relatively rapid structural evolution of the U.S. dairy industry that affects those factors; and the corresponding need to update those factors in a systematic fashion; describe the intensive and lengthy process that the National Milk Producers Federation has undertaken for the purpose of that

modernization; and ending in the five proposals that we have brought to this hearing, as well as two other proposals, two other recommendations whose -- we are seeking to achieve through other forums.

Also, included was a brief description of the economic and market impacts of our package of proposals, impacts on producers, processors, consumers, and small businesses. I will not repeat those -- those sections. They are identical in my statement Exhibit NMPF-6 as read into the record a week ago and as contained in Exhibit NMPF-6, which is available on the website.

This testimony -- this portion of my testimony is in support of Proposal 3 concerning surveyed commodity products. Proposal 3 can be described as remove the U.S. average survey price for 500-pound barrel cheddar cheese from the computation of the protein component price.

NMPF requests the Secretary to amend 7 CFR 1000.50(n) applicable to all Federal Milk Marketing Orders as specified at the conclusion of this testimony, which would remove barrel cheddar cheese -- or cheddar cheese packaged in 500-pound barrels from the cheese reference prices specified in the Federal Order protein component price formula.

Disorder caused by the inclusion of 500-pound barrel cheddar cheese prices in the current computation of the protein price:

The Class III milk price in Federal Orders is derived from calculations of component prices for protein,

butterfat, and other solids. The protein component price formula references two survey price series for cheddar cheese submitted by manufacturers through the Dairy Product Mandatory Reporting Program and reported in the weekly National Dairy Product Sales Report, or NDPSR. These are the 40-pound block yellow cheddar cheese price and the 500-pound barrel cheddar cheese price.

The total cheese price used in the protein price calculation is the weighted average of the block and the moisture-adjusted barrel price plus $0.03 per pound weighted by sales volumes reported in the survey. The respective reported sales volumes of block and barrel cheese are roughly equal on average but with blocks ranging from 37% to 60% of total reported weekly volumes from 2017 through this past July.

The Federal Order Reform final decision explained the current cheese price computation as follows, and I'm quoting, with a few explanatory words added in parenthesis in the written statement.

"The NASS cheese survey price" -- at that time it was NASS that was surveying the prices -- "will be determined by adding $0.03 to the moisture-adjusted barrel price and then computing a weighted average price" -- volume weighted average price -- "using the block cheese price and the adjusted barrel price... Including both block and barrel cheese in the price computation increases the sample size by about 150%, giving a better representation of the cheese market.

"Since the Make Allowance in the protein component price formula is for block cheese, the barrel price" -- "the barrel cheese price must be adjusted to account for the difference in cost for making block versus barrel cheese. The $0.03 that is added to the barrel cheese price is" -- emphasis here -- "generally considered to be the industry cost" -- "standard cost difference between processing barrel cheese and processing block cheese," end of quote.

This method of computing the cheese price for the protein component formula worked reasonably well as long as the difference in the respective market prices of blocks and the moisture-adjusted barrel price remained close to these assumed $0.03 per pound processing cost difference.

From 2000 to 2016, the spread between the NDPSR block and barrel cheese prices annually remained within a tight range of a few cents per pound. Subsequently, however, the correlation between the block and barrel prices deteriorated significantly starting around 2017.

The weighted average spread of block over barrel prices in the weekly NDPSR during January 2017 through July 2023 was $0.12 per pound, with a much wider and more volatile range of between minus 30 and a half cents per pound to 72.7 cents per pound. The highest monthly block barrel spread during that period, monthly spread, was $0.69 per pound and the lowest was minus $0.29 per pound, slightly -- slightly tighter range on the monthly basis

compared to the weekly basis. This change in the weekly price relationship is shown clearly in Figure 1.

And I apologize that my computer is set up to do two monitors, and so I can't -- I can't do the display setting on PowerPoint because it's on the other monitor that here is a phantom monitor.

But you will see the pattern. Again, this goes from the beginning of 2017 through this past July, with the weekly NDPSR reported price difference between, again, block prices and the moisture-adjusted barrel cheese price without the $0.03 in it.

The dotted line represents the $0.03 standard. The solid blue line represents the $0.12 average during that period, four times the current regulatory $0.03 standard, with a considerable wide variation, which, by any measure, an economist would describe as volatility in that barrel block spread.

The CME block cheddar cheese price is used as a pricing index for most cheese produced in the United States, cheddar 40-pound blocks, 640-pound blocks, mozzarella, other American type cheese, and other types of cheese, including cream cheese and Hispanic cheeses, typically use the 40-pound block price as an index for pricing purposes.

Approximately 90% of natural cheese produced in the United States is sold using the CME 40-pound block cheese price as an index. The CME barrel cheese price is used as an index to price barrel cheese and processed

cheese products, but it's not often used to price other natural cheeses.

Working with its cheese-producing member cooperatives and their expertise, NMPF estimates that the CME barrel cheese price is used to price only about 9% of total domestically-produced natural cheeses during calendar year 2022, including barrels themselves.

The volatile block barrel spread over the past five years has negatively impacted both dairy producers and processors. Historically, using both block and barrel cheese prices in the Class III pricing formula effectively increased the volume of cheddar cheese reported in the NDPSR. As long as the block barrel spread was relatively stable and consistent at around $0.03 per pound, including both block and parallel prices, did not result in unpredictable and disruptive fluctuations in the Class III price.

Since 2017, however, the significantly wider and increasingly volatile block barrel spread has caused instability in the cheese market. It has reduced dairy -- revenue for dairy producers because barrels, at approximately half of the price survey volume, and an average price roughly four times lower than current regulatory standard $0.03 per pound, overrepresented the roughly 10% of total U.S. cheese production that relies on the CME barrel market as a price index, which accordingly results in a Class III price that undervalues milk to produce cheese. It undervalues that milk to all producers

paid under Federal Milk Marketing Orders.

The proposed solution in Proposal 3 is to remove the survey price for 500-pound barrel cheese from the computation of the protein price. From the Federal Order Reform final decision quoted above it is clear that the intent of using barrel cheese prices to determine -- to partially determine the protein price was to bolster the volume of surveyed 40-pound block cheddar cheese. The purpose of determining the requisite price used -- cheese price used in the protein component formula. It did so by adjusting the barrel cheese price to resemble a block cheese price.

But what worked reasonably well for a decade and a half or so subsequently became a disorderly marketing condition when the market dynamics for barrel cheese deviated significantly from those for blocks. And the spread between the block and barrel prices widened and became unstable. Block and barrel cheddar cheese are no longer essentially the same product, simply in different packaging, as the current regulations effectively assume.

This widening and increasing volatility of the two prices no longer results in barrel cheese prices resembling block prices. The increase in the spread has lowered Class III prices, lowered producer prices, and created disorderly marketing conditions.

Eliminating the barrel cheese -- cheddar cheese barrel price series from the Class III price calculation will result in Federal Order pool values that more

accurately reflect the value of milk used to produce cheese. It will reduce financial uncertainty for procedures and processors by ensuring that the cheese price in the protein component formula represents the single basic commodity cheddar cheese product that prices almost all other cheese rather than what have effectively become two different products.

Price risk management opportunities for processors will be enhanced because there are risk management tools built around block cheese that do not exist for barrels. Existing risk management tools, including the Class III price and the cheese futures and options, will become more effective means to price cheese for consumers and to manage input price risk.

Eliminating the cheddar cheese barrel price series from the Class III price calculation will create more orderly marketing in Federal Orders for all of these reasons.

Calculated, again, just arithmetically, not an economic analysis, but simply an arithmetic calculation, eliminating the cheddar cheese barrel price series from the Class III price calculation would have increased the cheddar cheese price used in the Federal Order protein component calculation by 4.31 cents per pound, which would have increased the Class III price by $0.41 per hundredweight using average product prices for 2017 through 2022.

During 2019 through July 2023, the NDPSR weekly

survey volumes represented 33% of the total U.S. natural cheese production, 30% of U.S. dry whey production, and 9% of U.S. butter production. It is estimated that reported volumes of 40-pound block cheese represents about 16% of total U.S. natural cheese production.

Limiting barrel cheese from the protein component price formula would still provide adequate value of cheddar cheese for price discovery purposes in determining a component price for protein in the context of the corresponding percentages for butter and dry whey. Doing so would also bring the survey cheese price into conformity for those for butter, nonfat dry milk, and dry whey, in their respective Federal Order component price formulas, namely in their use in a truly single commodity product, with a single price, determined by a single spot market.

That consistently effective process -- practice for the other three products in their respective component price formulas, together with the unfortunate experience of deviating from that practice for cheese, lends powerful support for the adoption of Proposal 3.

This testimony provides an overview of our justification for adoption of Proposal 3. More detailed testimony will follow that supports all or key portions of Proposal 3, including testimony provided by Darin Hanson, representing NMPF member cooperative Foremost Farms USA, other members of the NMPF task force that developed our Federal Order modernization proposals, and producers who

are members of NMPF member dairy cooperatives.

Finally, the regulatory language we propose -- and I have written our regulatory language to reflect the total package of five NMPF proposals.

So our proposal for modification pursuant to Proposal 3 of Federal Order regulation CFR -- 7 CFR 1000.50 (n), protein price, the protein price per pound rounded to the nearest one-hundredth cent shall be computed as follows: Strike all subsequent parts of this paragraph and insert in lieu thereof:

(1): Subtract the cheese Make Allowance from the U.S. average AMS survey price for 40-pound block cheese reported by the Department for the month, and multiply the result by 1.383;

(2): Add the amount computed pursuant to paragraph (n)(1) of this section an amount computed as follows:

(i): Subtract the cheese Make Allowance from the U.S. average AMS survey price for 40-pound block cheese reported by the Department for the month, and multiply the result by 1.572; and

(ii): Subtract 0.9 times the butterfat price computed pursuant to paragraph one of this section from the amount computed pursuant to paragraph (n)(2)(i) of this section; and

(iii): Multiply the amount computed pursuant to paragraph (n)(2)(ii) of this section by 1.17.

This concludes my testimony.

Q. Thank you, Dr. Vitaliano.

MS. HANCOCK: Your Honor, we would submit him for cross-examination.

THE COURT: Yes.

Who has cross for this witness aside from AMS?

Mr. Rosenbaum.

CROSS-EXAMINATION

BY MR. ROSENBAUM:

Q. Good afternoon, Dr. Vitaliano. Steve Rosenbaum again for the International --

A. Good afternoon, Mr. Rosenbaum.

Q. -- International Dairy Foods Association.

So you are aware that the question whether or not the barrels should be included in the cheese price survey was a question that was addressed during the 2000 order reform?

A. Yes, it was -- I quoted the Department's conclusion, explanation, and justification for making the current decision, yes.

Q. And are you -- you are aware that at that time, your organization, National Milk Producers Federation, opposed the inclusion of barrels, but the USDA concluded otherwise?

A. Yes. My organization did oppose the inclusion of barrels as we are doing now, and we -- that was -- the Department did not agree with it.

Q. And are you -- you recall, of course, then there were subsequent hearings in 2006, I think 2007 as well,

resulting in a decision in 2008 that made a variety of changes to the Federal Order system, correct?

A. Yes. But I'm mostly familiar with the changes affecting the Make Allowances in those proceedings.

Q. Are you -- are you -- are you aware that at that time, once again, there was a proposal by not National Milk but co-op organizations to remove the barrel cheese from the survey?

A. I have heard that. I have not read that particular decision.

Q. I think National Milk sat out those hearings. Am I right about that?

A. I think so, because I do not recall that we participated in those hearings. And -- and I don't recall that we took a position on Make Allowances at that time. That was -- my impression is that that was the dominant topic of those hearings.

Q. Okay. Do you recall that USDA, once again, addressed the issue whether or not blocks should be included in the survey?

A. They must have because blocks are still included in the survey.

Q. Well, that they -- but it's not just that it is a carryover, they explicitly reexamined the question and determined that the decision they had made in 2000 was still correct?

A. Yes. But that -- given that -- that does not prevent us from recommending that and bringing Proposal 3

to this proceeding.

Q. And --

A. And I will point out to you that the Federal Order Reform discussions were held prior to 2000. The more recent proceeding that you reference was I think concluded in 2008. And you will hear me -- you will recall that I said many times in my written statement that -- that I just testified to, that the problems with including barrel cheese, even though National Milk recommended not including it way back in Federal Order Reform, the problem did not become acute and represent disorderly marketing until 2017.

So I would propose that my testimony primarily talks about the current dairy market, particularly the current barrel and cheese and block cheese market. Going back, again, to our overarching statement of purpose for what we're -- you know, our entire package of Federal Order modernization proposals was to recognize the changes that have occurred in the dynamic dairy market, in this case changes which take have taken place only since 2017, as being particularly pertinent to what we're testifying to at this hearing, and not necessarily to basically going back over the past, other than to create -- basically recreate the conditions that led to the decisions in the past that we still have today.

Q. Well, let's talk about some of the similarities or differences.

What -- what percentage of surveyed cheese today

is -- is block versus barrel?

A. In the survey?

Q. Yes.

A. It's a little -- it's a little more than 50%. I think it is getting up to about 54% of the reported volumes are barrels, and a little -- and the one -- you know, 100% minus that 54, 55. So I track those prices weekly, but I don't -- I don't memorize the numbers. But it's around 54, 55, 45.

Q. Okay. So if we look at the 2008 decision where USDA said, quote, "Record evidence reveals that barrel production in the NASS survey is often in excess of 50% of the total cheese volume surveyed," end quote, that remains true today, correct?

A. That remains true today, yes. Slightly more than the 50%.

Q. Okay. And --

A. And that -- and that is exactly part of the reason for our proposal, that that 54, 55% is vastly overweighted -- vastly overweights the importance of barrel cheese in the NDPSR weekly cheese price calculation, and therefore the monthly price calculation, compared to the volume of cheese that is actually priced with reference to the block cheese price versus the barrel cheese price.

So, yes, indeed, I fully agree with you, that that 50-some percent barrel cheese in the -- in the survey is very pertinent to Proposal 3 and our support therefor.

Q. Now, you say -- you make reference on page 4 of your testimony to -- to this $0.03 difference, correct?

A. That's correct.

Q. But correct me if I'm wrong, but I read that language -- this is on page 4 of your testimony -- to be entirely addressing the understanding of USDA as to the difference in the cost of making the products, not difference in the price at which the products are sold. I mean, just look at language you quote.

Is that a fair characterization?

A. No, I don't believe it is. Because even though they use that language, cost difference, and adjusting the Make Allowance, the entire context of that quote from the Federal Order -- from the Federal Order Reform decision implicitly assumes that barrel cheese is the same product as block cheese, only in a slightly different package, just like say the butter specification in the survey specifies metric and English units of package labeling.

The point I'm making is that the assumption for the Federal Order Reform decision to include barrels implies -- basically is found -- is built upon the assumption it's the same product in a different package; therefore, the only standardization necessary to bring barrel prices into a reasonable mimicking of block prices is the processing costs.

Q. Well --

A. That assumption no longer applies. These are two different products that behave in two different ways. So

in a sense, the standard for judging the appropriateness of including barrel cheese as a adjunct to -- as a different type of block cheese -- which is also very apparent in the language that you have just quoted, that paragraph -- that no longer applies. So it is perfectly pertinent to -- to do the analysis of the different marketing prices, as I have laid out in my testimony.

Q. All right. So let me read you the words, and you tell me where they are talking about price as opposed to cost.

Quote: "The barrel cheese price must be adjusted to account for the difference in cost of making block versus barrel cheese. The $0.03 that is added to the barrel cheese price is generally considered to be the industry standard cost difference between processing barrel cheese and processing block cheese."

It is all cost --

A. I interpret the use of the word "cost" in that paragraph to be totally in the context of the assumption in that paragraph that barrel cheese is block cheese in a different container. And the only -- the only thing that needs to be adjusted for the barrel cheese to compare it and treat it like block cheese is to adjust the moisture and adjust the cost, which is my understanding was basically just the -- the packaging cost.

And I am testifying to the extent that that assumption that barrel cheese is block cheese in a different package no longer applies. So the -- going back

to the 2000 -- 1999 language that uses the word "cost" is -- may have been appropriate at that time. It is no longer appropriate. And that is part of our position on Proposal 3.

Q. Well, if the two products had been absolutely identical, wouldn't -- what would be the point of even having included barrels --

A. To increase -- I'll read that. It's right in that paragraph, sir.

Q. All right.

A. "Including both block and barrel cheese in the price computation includes" -- "increases the sample size by about 150%."

You would always want to include -- increase the sample size if you indeed had consistent products.

Q. Aren't they --

A. It would make it -- it would make sense to do that if barrel cheese was effectively block cheese in a different package. But that's no longer the case.

Q. Haven't they always had different uses?

A. They always have.

Q. Okay. I mean, let me read you what CME --

A. But --

Q. Let me just finish.

Let me read you what the CME block cheese futures says, quote, "Although" -- and I'm going to ask you if you agree -- "Although blocks and barrels are both cheddar cheese products, their end uses are diverse. Typically,

manufacturers use block cheddar cheese for chunks, loaves, shreds, and snack-sized natural cheese, while barrels are often consumed in the processed cheese category."

Is that accurate?

A. Well, yes. What you just read makes -- further supports the point that we are making in supporting Proposal 3. The block and barrel cheese are different products, different end uses, and now increasingly very different market dynamics.

Q. Well, they -- they both represent market dynamics in the cheese market, correct?

A. They represent different market dynamics in the broader cheese market. We are talking -- in terms of Proposal 3, we are focusing on the dynamics of the block cheese market. And the Federal Order Reform decision effectively affirms that, that we're basically looking at considering barrels -- that decision considered barrel cheese to be a different kind of block cheese. They talked about using the Make Allowance for block cheese, and the only thing that needed to be adjusted was the difference.

Q. Well, they talked about the cost of making it -- they talked about -- strike that.

They talked about if you wanted to adjust the cost of making it --

A. Right.

Q. -- $0.03 would capture that?

A. In the overarching assumption that block barrel

was block cheese in a different kind of package. And implicitly, if at the time of Federal Order Reform we saw the kind of instability between block and barrel cheese prices, I would seriously doubt -- I cannot speak for the Department -- but I would seriously doubt that the Department would have made that decision.

MR. ROSENBAUM: That's all I have at this time. Thank you.

THE COURT: Mr. English.

CROSS-EXAMINATION

BY MR. ENGLISH:

Q. Good late afternoon, Doctor.

A. Good late afternoon, Mr. English.

Q. So let me start on page 5. And you say that National Milk estimates that the CME barrel cheese price is used to price only about 9% of total domestically-produced natural cheeses.

A. Yes.

Q. Now, that -- that -- that is different from the concept of the survey where more than 50% of the survey is barrel, correct?

A. Yes. And, in fact, my testimony specifically draws attention to the disparity between the 50%-plus weighting of barrels in the survey, and the only 9% in terms of its role -- barrel's role in pricing all natural cheese.

Q. So, now, when you talk about all natural cheese, though, that then is much larger than blocks, correct?

A. Much larger, yes.

Q. So now we're comparing -- you have got blocks, which you are okay with keeping in, but you want to exclude barrels because you are comparing barrels to all natural cheese. Isn't that an inept comparison? Shouldn't you be comparing blocks to barrels?

A. Can you repeat that question? I'm not sure exactly I fully understand it.

Q. Well, I'm the one who doesn't understand what is the relevance given the fact that -- well, let me backtrack.

When you use the phrase natural cheeses, what's include in natural cheeses?

A. Basically all cheeses except processed cheese, cottage cheese, the sort -- as I kind of loosely laid out, 40-pound blocks, 640-pound blocks, mozzarella, other natural cheese. In the practical sense, I would -- I would consider all natural cheese to be what is reported by USDA's National Agriculture Statistic Service, or NASS, under the categories of American cheese, including cheddar and other types, Italian cheese, including mozzarella and other types, and Hispanic cheeses, cream and Neufchatel cheese, Swiss cheese, those -- those things. Basically, the -- you know, NASS gives you the most disaggregated statistics on the production of various varieties of cheese.

Q. But aren't a lot of those -- and let's go back to mozzarella. We heard about mozzarella earlier this week.

Aren't a lot of those products a value-added products?

A. But they are cheese products. When you make mozzarella cheese, the Class III price is the appropriate price -- price that cheese manufacturers pay into the pool. I'm talking about whatever cheese prices, natural cheese prices, are produced for which the processors pay the Class III price into the pool. So the Class III price is a -- is a broad -- I'm looking at the universe of natural cheese as all cheese that is basically -- whose production pays into Federal Order pools at the Class III price.

Q. But isn't the whole point of using the blocks and the barrels because those are deemed to be the products that are commodity products, and Class III and Class IV are designed to be market-clearing prices?

A. The purpose of the products that are to be included in the product price formulas, and the NMPF modern -- Federal Order modernization process spent a lot of time on this, including examining things like unsalted butter, including mozzarella, 640-pound blocks, is to select the commodity product, the product that you make when you have milk that you have no other use for, but need to process it into a product, cheese, butter, nonfat dry milk, dry whey. That's the product -- that's the product that you want to have in your -- in your component price formulas.

In the case of butterfat formula, the case of the

nonfat solids formula, and the case of the other solids formula, you have a single product that is truly the commodity product that is in those formulas. For historic reasons, mainly to extend the volume reported, as going back to the quote on Federal Order Reform, the purpose of including blocks and barrels was the feeling at that time that just like butter, for example, is packaged in, you know, different kinds of package, labeled metric and otherwise, that blocks and barrels were the same product, and you simply had to adjust the moisture and put that $0.03 difference to basically a larger sample of the same product.

We are claiming in -- basically, in accordance with our overall procedure in approaching our recommendations for Federal Order Reform, look at how the industry has changed and how that affects the appropriateness of the formulas that were adopted, often without subsequent change, for instituting end product pricing. What may have made sense on barrels and blocks in 2020 and up through 2016, we claim no longer makes sense when you look at the fundamental purpose of the cheese protein price formula.

Q. I understand you say this -- but, now, isn't barrel cheese effectively exactly what you are saying, a product where you put milk as a matter of last resort?

A. In some cases. But the change -- the cheese industry is a very large industry in this country, and it may have two -- it clearly has two commodity -- or basic

commodity products. And the point we're making is that the commodity product, if you want to call it such, that is barrel cheese, is seriously overweighted in the reported volumes that set the Class III price compared to -- set the Class III price for determining the value of milk that dairy farmers produce that is used to make natural cheese seri- -- the inclusion of barrel cheese in the formula seriously overweights the importance of that -- of barrel cheese relative to the volume that it represents in terms of actually pricing natural cheese.

And that that imbalance, which does not affect the use of butter, nonfat dry milk, and dry whey, the single product in the other three component formulas, that product -- that problem does not exist. It exists in cheese because the Department chose for the purpose of enlarging the reported volumes on the assumption that we had the same product in different packaging types, basically has ended up causing problems.

And, therefore, we're effectively advocating for an approach to using a product -- a single -- truly single product, with a single price, and a single spot market, in all four formulas. We are advocating to bring the cheese price used in the protein component formula into conformity with the other three component price formulas.

Q. So -- but is there another product in butter that has ever been viewed to be a place where you put the excess butter when you have no other use for the milk?

A. In this country I -- my understanding is that --

is that 80% salted butter, according to the legislatively mandated standard, is where you put -- where you put your -- your excess cream if it could go nowhere else. We looked extensively, with some support in some of our members, at including unsalted butter as a way to increase the volume of butter, which is reported in the survey, which is about 9%. It is the lowest one.

And we had a vigorous discussion on that, and those of our task force who were involved in the butter business says, unsalted butter is not the commodity product, it is a specialty product, it doesn't necessarily have a standard. We will get to that at another -- another testimony.

Q. But the difference is milk used to make barrel cheese is the milk of last resort source, correct? That's where it ends --

A. In some -- in some areas of the country but --

Q. Well, are those people supposed to just be completely abandoned?

MS. HANCOCK: Your Honor, can he finish his answer, please.

THE COURT: Yes.

Mr. English isn't asking for an instruction here, but I do feel like there's starting to be disconnect between the question asked and the answers given. Mr. English asked whether there was another commodity used, and I don't -- I'm not even sure that ever got answered, but a lot else did.

So for the purposes of the record, I think I would ask the witness to answer the question asked a bit more directly and stop there unless further elaboration is required on that answer.

Is that okay with you, Mr. English?

MR. ENGLISH: It is. I also won't step on the answer. But I also do think that -- that I've had circular answers and sort of the same answer over and over again.

BY MR. ENGLISH:

Q. So I'm trying to understand, is milk used to make barrel cheese, at least in some parts of the country, the place of last resort for milk?

A. I don't have a detailed knowledge of the cheese industry to that extent, but that -- I would not disagree with your statement.

Q. And if those that price on blocks had a problem with the volatility in the block/barrel relationship, why would they continue pricing on blocks?

A. Could you repeat that question?

Q. If those that price their products, that you claim in this list on page 5, price on blocks, have a problem with the volatility in the block/barrel relationship, why would they price on blocks?

A. They price on blocks because that is the industry standard, and those who price on blocks, I'm not sure that volatility -- I mean, the dairy industry is full of volatility. What would be their alternative? They can't

stop the volatility by going to some other product.

Q. So the --

A. The --

Q. -- what are the barrel -- producers of barrels supposed to do if you eliminate barrels from the survey?

A. The barrel cheese, there is a spot market for barrel cheese that will, I assume, continue to function and -- and basically be a price discovery mechanism for the price of barrel cheese.

Q. But it won't be included in USDA's survey, which actually then results in the price of milk that they use to be changed, correct?

A. Yes.

Q. Will that not cause disorderly marketing when the entities that are trying to produce barrels have a disconnect with their price, that their price is no longer used for price discovery for USDA price-setting purposes but is used for price discovery purposes elsewhere?

A. Didn't you ask that that -- if that was reasonable?

Q. No, I asked if that's going to be disorderly marketing for them. What about those entities and the dairy farmers who ship to those plants?

THE COURT: Do you understand the question?

THE WITNESS: I understand the question, but my answer is, is it reasonable to expect dairy farmers through the Federal Order program to subsidize the production of barrel cheese at their expense of being

underpaid for the true value of the milk they produce that is used to produce cheese in the United States, under -- at least under the Federal Orders.

BY MR. ENGLISH:

Q. And yet you are going to exclude the value of the milk used to produce barrels?

A. We looked at the option of continuing to include barrel cheese in the formula, but to weight it more appropriately compared to its value in -- or to its -- to the proportion of barrels that -- that actually -- of cheese that is actually priced by barrels, which would have been a -- a weighting of the survey prices of around 90% blocks and 10% barrels.

That would have been unprecedented to, basically, enforce a weighting procedure, and the feeling was that would be disruptive in itself, in its -- by itself. It would require USDA to annually or periodically survey volumes. And decided that the 10% contribution from -- for barrel cheese would be not worth that extra effort, so we went, you know, the next step and said, let's just take barrel cheese out of the formula and return the cheese price to a single product, like the other three component formulas.

Q. So what's the point of having a survey if you are just going to say, we don't think this product is valuing milk correctly, and therefore we're just going to exclude it?

A. Well, under the current regulations, if barrel

cheese were excluded, USDA would no longer have the authority to require -- require its price to be processed to report -- be reported to the NDPSR.

Q. Precisely. And so as a result, the processors who make barrel cheese, products of milk of last resort, and the dairy farmers who ship to them, will be basically told, never mind, we don't want your product because we're not going to continue you in the survey.

A. I don't agree that excluding it -- that -- that having it excluded from the survey would amount to a -- to a determination or a declaration that we don't want your product anymore. Processed cheese is going to continue to be -- to be produced. Barrel cheese will continue to be produced, will continue to be priced. And -- and so I'm not sure I agree with the presumption behind your question.

Q. Why shouldn't industry practice, that is to say the fact that barrel cheese is being produced, conform to industry regulation, rather than the other way around?

A. If the regulation is causing disorderly marketing conditions, then the regulation should be changed. That's why we're here.

Q. And the disorderly marketing is that somehow as a result of including milk for last resort going into barrels, is somehow undervaluing milk for dairy farmers, correct?

A. It is, yes.

MR. ENGLISH: I have no further questions.

THE COURT: Any further cross aside from AMS?

Yes, Mr. Miltner -- so it is 5:02. I would ask -- that's our -- we're after our normal cutoff. I don't know how much cross you have, Mr. Miltner. I don't know how much cross AMS has. I think we could -- or how much redirect there would be. I'm suggesting we come back tomorrow with this witness.

MS. TAYLOR: I think that's a good idea.

THE COURT: Okay. With that, we'll return tomorrow morning at 8:00 a.m. to resume the examination of this witness.

(Whereupon, the proceedings were 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: September 14, 2023

FRESNO, CALIFORNIA

MYRA A. PISH, RPR CSR
Certificate No. 11613