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

September 7, 2023

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

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IN CHRONOLOGICAL ORDER:

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THURSDAY, SEPTEMBER 7, 2023 - - MORNING SESSION
THE COURT: Okay. Good morning.
Ms. Hancock, how are you?
MS. HANCOCK: Thank you, your Honor. We would call Christian Edmiston.
THE COURT: Welcome back, Mr. Edmiston.
CHRISTIAN EDMISTON
Being first duly sworn, was examined and testified as follows:
THE COURT: Your witness, Ms. Hancock.
DIRECT EXAMINATION
BY MS. HANCOCK:
Q.   Good morning, Mr. Edmiston. Welcome back to the stand for your second round.
Are you here this time to testify on behalf of our Make Allowance proposal for National Milk?
A.   I am.
Q.   And did you prepare a witness statement on behalf of the position that you are going to be providing us today?
A.   I did.
Q.   Is that what's been previously identified as Exhibit NMPF-14?
A.   Yes.
MS. HANCOCK: Your Honor, if we could mark this for identification purposes.
THE COURT: Yes. All right. I have our next exhibit as 144. That exhibit will be marked for

identification as 144.

(Thereafter, Exhibit Number 144 was marked for identification.)

MS. HANCOCK: Thank you.

BY MS. HANCOCK:

Q. Mr. Edmiston, would you go ahead with your statement?

A. Yep. So I'm going to skip the bio portion of my statement, and I'm also going to jump around for the sake of brevity. I'm going to do my best to read slowly.

So starting at the bottom of the first page -- I already got ahead, didn't I? I'm going to work on that, I promise.

Land O'Lakes acknowledges that these increases, if implemented, would not fully offset the increases in manufacturing costs for commodity-style butter, nonfat dry milk, cheddar cheese, and dry whey, experienced by our manufacturing plants since 2008 when the current Make Allowances were implemented. Instead, these increases offer a balance between the producer price impact from raising Make Allowances and the processor cost impact of raising Make Allowances.

These increases reflect the current cost of manufacturing commodity-style butter, nonfat dry milk, cheddar cheese, and dry whey more closely than current Make Allowances. Increasing Make Allowances to these levels strikes a balance between updates that are needed as a result of disorderly marketing conditions, detailed later in this testimony, and dairy producer profitability.

Raising Make Allowances to levels above these proposed levels will reduce producer prices and would narrow producer margins on the farm that could negatively impact the availability of adequate supplies of milk and thereby also create disorderly marketing.

MS. HANCOCK: So I'm going to interrupt you. I think you can read a little bit faster, just so that it's a little bit more conversational, because I think for our own sanity, we can't listen to that.

THE WITNESS: I don't disagree with you. It is a challenge. And I know I speak way too fast.

THE COURT: Thank you, Counsel.

MS. HANCOCK: And we'll figure it out. It was very kind of you.

THE WITNESS: I'm trying. I swear I'm trying.

MS. HANCOCK: But we're only one paragraph in, and I was already hurting.

THE WITNESS: Let's give this another chance.

So I'm going to skip ahead. I'm going to go to, "In my testimony, I will speak to the following points," and then I'm going to pause and check for pace at that point.

(1) Commodity manufacturing costs have increased by any measure since 2006 and exceed the current Make Allowances for all four commodities;

(2) Outdated, undervalued, inadequate Make Allowances have led to, and will continue to lead, to

disorderly marketing conditions;

(3) Producer impacts of increasing Make Allowances must be taken into account by USDA;

(4) The industry needs a mandatory audited survey of commodity manufacturing costs to provide data to use in discussions to propose updates to the Make Allowances.

Number 1: Actual audited manufacturing cost data from plants making the four commodity products represents the ideal data for USDA to use in establishing Make Allowances. Since no data has been collected by mandate, audited, and reported that covers the relevant population of plants processing these four commodity products, USDA should consider actual cost data voluntarily submitted by processors who manufacture these commodity products.

Land O'Lakes operates two manufacturing plants that produce branded butter and commodity-style nonfat dry milk. These plants are located in Tulare, California, and Carlisle, Pennsylvania. The Tulare plant is regulated under Federal Order 51, and the Carlisle plant is regulated under Federal Order 1. Combined, our Tulare and Carlisle plants process over 13 million pounds of producer milk per day. The manufacturing costs per pound of commodity product at both plants have increased since 2006, as shown in the tables below.

So I'll speak to the tables briefly. This reflects an aggregation of the data that we submitted to the Stephenson surveys. For -- you know, for the reason of wanting to keep our data -- our proprietary data out of the record, we provided aggregations.

And so what you see here are individual categories that we reported for butter, for nonfat, and then all other categories across butter and nonfat combined together, with the increases from the 2007 Stephenson survey to our actual costs on a percentage basis in the final column.

Land O'Lakes also operates a cheese plant in Kiel, Wisconsin. We have made significant investments in this plant to update the cheese and whey processing facilities, which has led to increased manufacturing costs per pound of cheese and per pound of dried whey since 2006.

Stephen Cain, National Milk economist, conducted an analysis that uses cost indexes to update commodity manufacturing costs from the 2006 levels. The results of that analysis show that commodity manufacturing costs have increased since 2006 and that the current Make Allowances need updating to reflect these increased costs.

Dr. Bill Schiek was also commissioned by IDFA to conduct similar analysis which likewise shows that commodity manufacturing costs have increased since 2006 and shows that current Make Allowances need updating.

The voluntary surveys conducted by Dr. Mark Stephenson using 2018 and 2022 costs provide more data that shows commodity manufacturing costs have increased since 2006.

In summary, it is clear that manufacturing costs have increased since 2006. This is confirmed by Land O'Lakes data, efforts to update past cross-surveys, and recently conducted voluntary cost surveys. However, the ideal data would be provided by a mandatory and audited survey does not exist today.

Number 2: Under Federal Order Reform, product price formulas replace the previous direct survey of prices paid for manufacturing grade milk. PPFs moved the process of establishing the basis for Federal Order pricing up the marketing chain one step to survey unregulated plants buying and selling of wholesale spot, commodity-style, dairy products.

The dairy products referenced in the Class III and Class IV pricing formulas are primarily commodity products, not retail or branded products. Those dairy product prices became the foundation, working backward via economic formulas, to determine the minimum price of milk used to make the four commodity dairy products. Adjusting the survey prices by subtracting the non-milk cost of manufacturing these products and applying appropriate yield factors, determines an implied value for the components of milk used to produce them.

Having accurate and updated plant processing costs, or Make Allowances, and appropriate product yield factors, are critical for this indirect method for determining prices, which is a principal function of the Federal Order program, yet a regular and systematic method of ensuring that these critical PPFs remain accurate and current has not been established. More importantly, PPFs do not work as they were designed to when Make Allowances are not reflective of actual costs.

I'm going to skip through the quotes.

When Make Allowances are undervalued, disorderly marketing conditions ensue, including lack of investment in manufacturing plants to process and balance milk supplies, inequitable pay prices to producers participating in the same market.

Inadequate Make Allowances challenge manufacturing operations' abilities to pay minimum announced milk prices and still operate at reasonable competitive rates of return. Inadequate Make Allowances discourage plant investments needed to meet milk supply and product demands on a daily, seasonal, and annual basis.

When manufacturing costs of commodity products exceed the established Make Allowances, the calculated classified prices will essentially overvalue raw milk as an input.

Cooperatives operate dairy manufacturing plants in nearly all Federal Orders. Many of National Milk's member cooperatives own and operate plants that manufacture commodity dairy products.

To maximize plant throughput, cooperative organizations produce commodity-style products even though these products have a smaller margin than branded products. This approach of maximizing a plant's processing capacity is especially important in clearing the milk supply available to local markets and utilizing milk processing assets more fully.

Many of these manufacturing plants also balance milk supplies when Class I, II, and III customers require more or less milk to meet their finished good demand needs. In this way, cooperative manufacturing plants balance the market by market -- balance the market by providing an outlet for milk not needed by their customers on a monthly, weekly and even daily basis.

Typically, balancing plants do not run at full capacity and are used as needed. This milk market balancing function implies running plants below full capacity, which increases the operating costs per unit of commodity plants.

Cooperatives making commodity-style products operating under Federal Orders cannot recover a larger margin on their commodity products. If they raise their commodity product prices to capture a larger margin to cover higher costs, those higher prices go directly into the class prices and effectively eliminate the larger margin. In effect, the Federal Order Make Allowances are the fixed margins to commodity production at cooperative plants.

Margins on commodity products are very low, typically only a few cents per pound. Given the cost of new plant construction that can easily run into multiple hundreds of millions of dollars, the decision to build new capacity for commodity and balancing plant assets is difficult. Similarly, when existing plants see compressed margins, a natural first response is to attempt to cut costs.

Unfortunately, sometimes this comes in the form of underspending on needed maintenance. While this process of, quote, "bleeding the assets," end quote, can work for the short-term, it eventually results in devalued assets and shorter asset life.

When Make Allowances undervalue actual manufacturing costs, producer pay prices and their respective milk price returns are not equivalent. Producers participating in markets in which their cooperatives process a large portion of the producer milk into Class III and Class IV commodity products are disadvantaged competitively when Make Allowances undervalue the cost of processing that milk.

In short, outdated, undervalued, inadequate Make Allowances compress margins at cooperatively owned commodity manufacturing plants and place an unfair burden on cooperative producer members compared to producers who are not members of milk processing cooperatives.

I'm going to skip ahead.

Cooperative members experience these impacts through discounted milk prices going into their own plants to account for Make Allowances that are set too low, thus reducing current month milk checks, or pricing the milk closer to or below class prices, knowing there will be negative returns at their plants to be covered at the end of the financial year.

Data from AMS shows the effect of both these discounts and the lack of investment in manufacturing plants to process and balance milk supplies. As Make Allowances have fallen further behind, actual commodity make costs, spot milk premiums have trended lower, as shown in the table.

These negative impacts absorbed by cooperative producers stem directly from Make Allowances that are set too low and are further exacerbated by the critical role that cooperatively-owned manufacturing plants play in balancing milk supplies in FMMO markets.

Cooperative manufacturing plants represent financial investments by their members. Cooperative members have paid to build and maintain their cooperative manufacturing plants and are responsible for the costs to operate them.

When Federal Order Make Allowances are established at levels below the cost of producing commodity dairy products, farmers whose cooperatives own and operate balancing plants end up absorbing those costs that other market participants do not experience. However, all producers benefit from the orderly marketing system enabled by cooperatives operating milk balancing plants within the market.

As cooperatives pass the marketwide balancing losses on to their members via reduced pay prices, producers shipping to handlers that do not operate balancing plants do not experience these lower pay prices. This unfairly penalizes dairy cooperative members who invest in plant and marketing systems to support orderly marketing.

The outdated Make Allowances need to be revised to account for increases in costs to produce butter, nonfat dry milk, cheddar cheese, and dry whey. USDA should consider the best plant processing cost data available when updating Make Allowances.

However, given the length of time since the last Make Allowance update, making the sudden change to Make Allowances to fully reflect current manufacturing costs would be very disruptive to dairy producers and impose undue financial hardships on them.

Let me skip down.

Assuming the implementation of the proposed increase in Make Allowances, dairy market supply and demand factors for milk and dairy products would likely mitigate some of the initial price impact on milk producers.

Nonetheless, it cannot be overstated the impact of increasing Make Allowances will negatively impact producer milk prices and their margins will be compressed. Make Allowance increases larger than those proposed by National Milk will have a larger and negative impact on milk producers' margins and increase the likelihood of jeopardizing the milk supply going forward.

The larger changes in Make Allowances proposed by

IDFA and Wisconsin Cheese Makers Association, at the end of four years, would narrow producer margins to levels that would significantly impact producer profitability and put the availability of adequate supplies of milk at risk and, thereby, lead to disorderly marketing.

Producer margins have become significantly compressed in the first half of 2023 and may be more compressed in the second half of 2023, perhaps into 2024. Class III and Class IV prices have averaged $5.47 and $6.08 per hundredweight lower through June compared to 2022 and have translated into major decreases in FMMO uniform prices.

USDA projects the 2024 U.S. all milk price will drop to $19.10 per hundredweight. That represents a decrease of $6.24 from the 2022 all milk price of $25.34 representing a decrease of nearly 25%. This drastic drop in milk price, without a similar decrease in other milk production costs, has narrowed margins on many dairy farms to the point of being below their cost of production.

Income over feed is shown in the chart below as a proxy for producer profitability. Historical data is from USDA Ag Prices reports, while corn, soybeans, Class III, and Class IV futures are used to show estimates of profitability into 2024, which remain near the 25th percentile of the ten-year history of data.

So to describe this chart a little, it actually uses the feed ration that's not quite USDA ration. And I need to make one little correction. It doesn't include soybeans; it includes soybean meal. The development of that ration was done in cooperation with our Purina formulators. It uses a simple regression of Class III and Class IV versus all milk price to project milk prices into the futures, as well as, as I mentioned, corn and soybean meal prices to project ration costs.

I'm going to skip section 4 altogether and go to summary.

Land O'Lakes recommends that the Department increase the Make Allowances as proposed by National Milk. Land O'Lakes believes that the proposed Make Allowances are adequate, acceptable, and reasonable. These increases represent an interim step in aligning the Make Allowances more closely to actual manufacturing costs being experienced by processors of commodity dairy products.

Land O'Lakes manufactures these commodity products and has experienced a significant increase in manufacturing costs since 2006. This is corroborated by recent voluntary studies conducted by Dr. Mark Stephenson, an analysis that updates the 2006 manufacturing costs using publicly available cost indexes.

The effect of outdated Make Allowances that are set too low is to create disorderly marketing conditions, mainly in the form of lack of investment in manufacturing plants to process and balance milk supplies and inequitable pay prices to producers participating in the same market.

It is clear that commodity manufacturing plants, especially those that are tasked with balancing milk supply and demand, struggle to make a profit since the effect of undervalued Make Allowances is to overvalue milk prices. This leads to a lack of investment in manufacturing capacity.

At the same time, losses on existing plants are shouldered by producers that have made the decision to invest in commodity processing assets creating inequitable pay prices for those producers which has been established in past decisions as a form of disorderly marketing.

The cost of maintaining the market balancing facilities must be borne by the market, not only by the owners of the facilities. However, the last Make Allowance updates in 2008 using 2006 data, and the gap between those Make Allowances and various estimates of current commodity manufacturing costs, are substantial.

As a result, National Milk has proposed Make Allowances that strike a balance between a necessary update and producer profitability that is obviously challenged in the current market landscape. The risk of not striking such a balance is jeopardizing milk supply and creating more disorderly marketing conditions.

Longer term, the industry needs a mandated audited survey of commodity manufacturing costs to provide the best data for future updates to Make Allowances. This is the one request that is included in both National Milk and IDFA petitions and supported by several other interested parties that submitted petitions as well.

Land O'Lakes thanks the Department for calling this hearing to consider the modernization of Federal Milk Marketing Orders.

BY MS. HANCOCK:

Q. Thank you, Mr. Edmiston. I just wanted to dive into a couple of items in your testimony to make sure that it is clear on the record what you are doing.

Can you turn to page 3 of your testimony, the chart that you have created comparing the percentage of increase of Land O'Lakes' cost with Stephenson's survey?

A. Yep.

Q. I'm just wondering if you can expand on that or maybe even reiterate what you had provided by way of an explanation as to what this is designed to show.

A. Yeah. Basically it's designed to show that our costs of making butter and nonfat dry milk have increased since the 2007 Stephenson survey. We were -- we were not interested in putting our actual costs into the record but wanted to show that our costs have increased, and so we did some aggregation and pulled out some separate factors that were components within the Stephenson survey, so, for instance, processing labor and utilities.

The 2007 column is the Stephenson survey weighted averages in those -- in those categories. The last column is the percentage increase from the 2007 Stephenson survey to our actual costs that we submitted in the 2022 Stephenson survey.

Q. Okay. So does that mean if we look at under

butter for processing labor, Stephenson has $0.0522 there for his weighted average in processing labor, right?
A. Correct.
Q. And then your 50% increase, is that a 50% increase over the 2007 number?
A. Correct.
Q. Okay. And -- okay. I think that helps.
And then I just want to maybe take a step back and put this into perspective. I mean, I think what you are saying is, is that there's no doubt that processing costs have increased over the Make Allowances as they are currently set. Is that fair?
A. Correct.
Q. And it sounds like there's no dispute probably in the room about that aspect?
A. Agreed.
Q. But you're -- you acknowledge that you're -- that on behalf of National Milk, you're making a recommendation that is likely somewhat less than what the actual Make Allowance costs would be if they were calculated at your current actual costs; is that right?
A. Agreed.
Q. Do you know, as you sit here today, how much less it is?
A. Than the industry cost?
Q. Yeah.
A. No.
Q. Okay. Sorry.

A. Go ahead.
Q. No, you go. I want to hear what you have to say.
A. And as -- you know, as discussed in previous testimony, I think it's a function of, you know, not having mandated audited survey data to provide the actual cost for the industry. So the voluntary survey takes -- you know, takes a shot at it, and I think, you know, does a -- does a -- you know, gets us a certain distance towards it, but we don't have the actual costs for the industry via mandated audited survey to rely on.
Q. Okay. And you understand that the proposal from IDFA also has somewhat of a tempered, I guess, year one starting point as well for their proposed Make Allowance; is that your understanding?
A. Yes.
Q. And then what is your understanding about when it would get to full amount that they believe is the Make Allowance number?
A. I believe it is four years later.
Q. Okay. And what do you -- how do you feel about that proposal?
A. As stated in my testimony, I think it -- it risks impacting producers to an extent that, you know, it would be untenable for certain portions of the producer community.
Q. Do you have any concerns about whether it -- there's a risk in there that it could capture an amount that is in excess of the actual Make Allowances?

A. Yeah, I think that's possible.
I also think that we don't know what costs are going to do going forward. So to lay out a four-year roadmap of what -- how Make Allowances are going to change without knowing necessarily what costs are going to do going forward, you know, is a bit of a challenge.
Q. And -- and for the proposal that is submitted by National Milk, I think that -- that in your testimony on page 7, when you are talking about those numbers, you state that any larger changes to the Make Allowance would put too much pressure on dairy farmers.
I'm wondering if you can talk about what process you undertook to -- to participate in National Milk's decision to put forth the numbers that it did that's stated in your testimony?
A. Yeah. So -- and it was discussed yesterday by Dr. Vitaliano. You know, we needed to reach a consensus among the National Milk members. We knew that we needed something on Make Allowance. And so it was a long process of trying to figure out the right balance across all five proposals that we ended up with to -- you know, to come up with a set of Make Allowances that -- that we could -- that we could all support.
There was kind of an informal survey process done among National Milk membership, and that was kind of the driver for how we landed on the numbers that we landed on.
Q. And do you believe that you left much headroom that producers could actually absorb more than what

National Milk proposed for the increase in Make Allowance for year one?

A. Can you restate that question? I'm sorry.

Q. Yeah, I'm just -- I mean, what I'm wondering is did you go soft on the dairy farmers? Did you -- did you suggest a number where you thought, well, if the USDA doesn't like that number, we have left some head room where they could absorb more?

A. No. I mean, you know, it's a balancing act. Right? One of the things that I really like about the role that I have and the company that I work for is we do both. You know, we run manufacturing plants, and we have to -- we have to do that. And we also represent dairy producers, and we have to do that. We have a dual mandate in that respect.

And so, you know, we were trying to find that balance across all of membership that -- that we could support at National Milk, but we were also trying to find that balance between what we thought producers could bear and what we thought we needed for our manufacturing plants as well. So it was a balance -- it's a balancing act.

And, you know, I think that as you look at both the National Milk and the IDFA proposals, given that it's been 15 years since we have updated these, there's no easy, obvious, perfect answer here. Right?

I think Mr. Rosenbaum put it correctly yesterday that, you know, we -- we may have -- we have a bunch of things we agree upon. There are things that, you know, we may differ in approach on. But directionally, I think, you know, both National Milk and IDFA see a need here. It's just a matter of how you strike that right balance given your stakeholders and given what you think is best for the industry.

Q. Thank you. Appreciate your time.

MS. HANCOCK: Your Honor, we would submit Mr. Edmiston for cross-examination at this time.

THE COURT: Yes, Mr. Rosenbaum.

CROSS-EXAMINATION

BY MR. ROSENBAUM:

Q. Steve Rosenbaum for the International Dairy Foods Association.

Mr. Edmiston, did Land O'Lakes participate in the Stephenson survey that was conducted in 2007 used to set the current Make Allowances?

A. Yes, sir.

Q. And did Land O'Lakes participate in the 2021 survey that Stephenson conducted at USDA's behest?

A. Yes, sir.

Q. And did Land of Lakes participate in the 2023 survey that Dr. Stephenson also conducted?

A. I want to draw a distinction, if I could.

Q. Yes?

A. You mentioned a 2021 survey. I thought you were referring to the 2023 survey.

Q. Right.

A. Because the 2021 survey actually started in 2019.

Q. Okay.
A. I just want to make sure I'm answering the question correctly. Sorry.
Q. Yeah. Assigning the exact years to these things can be challenging because the survey covered a period. It's obviously the date of the actual result.
A. Let me answer it differently.
Q. Did you participate in all three surveys?
A. Yes. That's exactly how I was going to answer it.
Q. That simplifies it.
And I assume that Land O'Lakes did its best to submit accurate information?
A. Absolutely.
Q. And now, counsel -- your counsel asked -- or counsel from National Milk asked some questions regarding the IDFA proposal, which she actually accurately characterized as phasing in increased Make Allowances over a four-year period, correct?
A. Yes.
Q. But do you understand that the end result of that, that is to say the highest number, reflects what IDFA submits are the current costs of manufacturing?
A. Yes. Although I believe, correct me if I have this wrong, I believe they are slightly different than the Stephenson survey results.
Q. They are an amalgamation of the Stephenson results and Dr. Schiek's work, and we'll have testimony on that.
With that caveat, though, do you understand that

the IDFA proposal reflects, from IDFA's perspective, Make Allowances that at their fully-implemented level will be the current cost to manufacture as of now?
A. I understand that that is -- that's IDFA's perspective, yes.
Q. In other words, if the proposal to increase Make Allowances over time, does not reflect an effort by IDFA to project future increases in costs, it reflects the current costs, correct?
A. Yes, I understand that.
Q. And do you understand the phase-in reflected an effort to accommodate farmer concerns that implementing the entire Make Allowance increase at once would be quite -- would be -- you know, would be substantial?
A. So it's interesting you mention that. I didn't necessarily understand the justification for the phase-in that IDFA proposed. I suspected that it was an effort to -- to realize that implementing those all at once would impact farmers. I hoped that was the case, but I didn't necessarily know that that was the case. So it's good to hear that.
At the same time -- you know, I mentioned the dual mandate that co-ops have, co-ops like Land O'Lakes that both represent producers and process milk. You know, in terms of understanding what's best for producers, we're in it every day. I have to stand up in front of producers on a very regular basis and talk about things like this, and I have done so over the last several years, as we knew the

Make Allowance hearings were coming.

And I have had producers in very stern tones tell me, don't go too far with this. And they had fears about that. You know, producers that were already financially struggling and could see that going too far with the Make Allowances all at once would be very negative for their operations and their businesses.

So that kind of justification is what I believe drove the National Milk membership as a whole to come up with the proposal that we did.

Q. So let's -- what I'd like to do now is switch discussion a bit to the question of what the increase in costs of manufacture have actually been since Dr. Stephenson conducted his survey in 2007, which was used in part to set the current Make Allowances.

Just so we orient ourselves, you are aware that the actual Make Allowances as set were themselves an amalgamation of Dr. Stephenson's survey as well as information from the California Department of Food and Agriculture, correct?

A. Correct.

Q. Okay. So I would like to -- and my questions now are really going to focus on the table on page 3 of your report.

A. Okay.

Q. So in the second column, you make reference to Stephenson's survey weighted averages, correct?

A. Yes.

Q. Okay. So that we all can make sure we understand exactly what you did here -- and I think I understand, but you're going to correct me if I'm wrong -- let me hand you a copy of that -- of that Stephenson survey report from 2007.

A. Sounds good. And hopefully the numbers that I have in there are all correct.

MR. ROSENBAUM: Your Honor, I would ask that this document be marked with the next Hearing Exhibit number.

THE COURT: IDFA Exhibit 28, top right-hand corner, is marked for identification as Exhibit 145.

(Thereafter, Exhibit Number 145 was marked for identification.)

BY MR. ROSENBAUM:

Q. And, Mr. Edmiston, can you identify this as being the Dr. Stephenson 2007 report?

A. Certainly appears to be.

Q. And this is the document that you relied upon, in part, in putting together the table that appears on page 3; is that correct?

A. Yes.

Q. Okay. So let's just go through the different headings on that document -- on that table -- excuse me -- in your report.

So you start with butter, and you are providing combined data for your -- for two plants -- is it Tulare?

A. Tulare.

Q. -- Tulare and Carlisle, correct?

A. Yes, sir.
Q. And for -- and then you have a row for processing labor and a row for utilities, correct?
A. Yes, which I believe is marked in Dr. Stephenson's survey as energy.
Q. Exactly.
So if you turn to page 8 of Dr. Stephenson's report, which is Hearing Exhibit 145, there is a column that says labor, correct?
A. Correct.
Q. And it says $0.0522?
A. Correct.
Q. Same as 5.22 cents, correct?
A. Why is.
Q. That is the source of the information in the second column of your table on page 3, correct?
A. Yes, sir.
Q. And then similarly, there is an entry that he calls energy, which is $0.0157, correct?
A. Yes, sir.
Q. And same as 1.57 cents, correct?
A. Correct.
Q. And that is the number that you used for -- that you termed utilities, correct?
A. Yes, sir.
Q. Okay. Similarly, on keeping -- going further down on your table, you have -- then have an entry for nonfat dry milk. And if we turn the page in the Stephenson

report, Hearing Exhibit 145, to page 9, we see that there's an entry for labor of $0.0362, correct?
A. Correct.
Q. And that's the number that appears in your second column with respect to processing labor, correct?
A. Correct.
Q. And then similarly, there's an entry for energy of $0.0409, which is 4.09 cents, and that's what you entered for utilities in -- under the nonfat dry milk heading in the second column in your table, correct?
A. Correct.
Q. Okay. Now, continuing further down, you then have a row that's called butter and nonfat dry milk solids basis, and underneath that you have all other, correct?
A. Correct.
Q. And there you have $0.1009, correct?
A. Correct.
Q. So if we go back to Dr. Stephenson's report, Exhibit 145, there are a number of entries in addition to the labor and energy entries that we have already talked about; namely, there's an entry for packaging, for repair and depreciation, G&A, general administrative, ROI, return on investment.
Did you lump those together to come up with the all other?
A. Correct. And then weighted on a solids basis across butter and nonfat dry milk.
Q. Okay. And so you -- you added those up -- you

added up the numbers -- I'm looking at page 9 for nonfat dry milk plants --
A. Yes, sir.
Q. -- in Exhibit 145.
So you added up the numbers for packaging, repair and depreciation, G&A, and ROI from that page, correct?
A. Correct.
Q. And then did you do the same thing with respect to the information on the previous page that related to butter?
A. So in effect, I did the same thing that you just described --
Q. Okay.
A. -- but I did it a little differently.
Q. Okay.
A. I subtracted the ones that are delineated specifically from the total.
Q. Yes. Of course.
A. And -- on both, correct.
Q. Yes. And then what did you do -- so that would give you a number for butter --
A. Yes.
Q. -- from page 8 and a number from -- for nonfat dry milk on page 9, correct?
A. Yes.
Q. And then what did you do with that to come up with your 10.09? Did you add them up and divide by two or --
A. I believe they are weighted roughly two to one --

Q. Okay.
A. -- based upon nonfat solids versus butterfat solids.
Q. That's the -- you did that weighting, you are saying?
A. Land O'Lakes FP&A did that weighting.
Q. Okay.
A. Because I don't keep track of -- it's not part of my responsibility to keep track of our -- our costs, and as we were -- as we were putting this together, that analysis was done by our finance group.
Q. So the $0.1009 that appears in the other -- all other row, that is a weighted by --
A. Solids.
Q. -- solids average of the Stephenson cost data for butter and for nonfat dry milk; is that correct?
A. Correct. And directionally, just doing math off the top of my head -- which is risky on the stand, but I'm going to try it anyway -- if you average the two Make Allowances, you are going to get about $0.175. If I add up the specifically delineated line items here, you get roughly $0.07 apiece. 17 minus roughly 7 is about 10.
So if there was a mistake made in the calculation to the third or fourth decimal point, I suppose that's possible. But directionally I believe the $0.10 to be relatively reflective of all of the other categories in nonfat and butter in the 2007 Stephenson survey.
Q. Okay. So let's now -- and if you were actually

making butter and nonfat dry milk, you would, if you will, incur the $0.1009 twice; is that fair to say, once in making the butter and once in making the nonfat dry milk?
A. Those are on a per pound basis for products that you get out of milk.
Q. Right. So on a -- on a -- if you will, is it fair to say that on a per pound basis, if you wanted to know the per pound cost of butter based upon the 2007 Stephenson survey, you could add the processing labor number and the utilities number and the all other number?
A. Not here because the last portion, the all other, is both butter and nonfat.
Q. Okay. All right.
A. In the Stephenson survey, yes.
Q. Yes, okay. And here -- and here the all other is it fair to say that the all other times two would be the combined per pound all other costs for butter and nonfat dry milk?
A. I'd have to think about that, in the way you are characterizing it. Is there a subsequent question that you are looking to answer?
Q. Well, I'm just trying to understand your -- your approach. I mean the 10.02 -- as I understand it, you, for competitive purposes, did not want to reveal with precision what Land O'Lakes costs are --
A. Correct.
Q. -- that are in the all other category, correct?
A. Correct.

Q. So you came up with a number that is a -- if you will, a weighted number, so that the real numbers, so to speak, for butter may be somewhat higher and the real number for nonfat dry milk would be somewhat lower, correct? Or vice versa as --
A. Or vice versa. I mean, the point is -- the point of the table, honestly, is to show that our costs have increased since the 2007 survey.
Q. Okay.
A. The way in which we put the table together, I have think you have -- I think you have correctly -- I think we, collectively, have collectively established. Drawing further conclusions past that by -- by multiplying the all other specifically across both butter and nonfat by two, I haven't had time to think about how you would characterize such a calculation, if that makes sense.
Q. All right. Well, let's just -- then let's just stick with the numbers as they are right here and give me one second.
So am I correct that the only amalgamation of data you did in order to protect confidentiality or competitiveness is with respect to the all other number?
A. Also across butter and nonfat dry milk. So we amalgamated the all other using the different categories that aren't processing labor or utilities, and we also amalgamated across the commodities.
Q. Yes. So you protected individualized information in two ways. First of all, you amalgamated them together

as opposed to breaking them out into these separate subcategories of packaging, repair and depreciation, G&A, and ROI, correct?
A. That's right. I would also point out that, I believe -- I believe that the categories change slightly from 2007 to 2022 in what we were asked to provide for the Stephenson survey. And so making a comparison across the 2007 and 2022 category by category wouldn't really have been possible using the same categories. That was part of the rationale as well.
Q. Okay. So you added the entries together rather than breaking them out separately, you added them together and put them in all other, plus you put both butter and nonfat dry milk together. Those were both things you did to -- to protect the certain level of confidentiality, correct?
A. Correct.
Q. But when it comes to the number you have for processing labor -- and take butter as an example where it's $0.0522. Okay? Now, you have indicated in the last column, as I understand it, that Land of Lakes' actual 2022 processing costs are 50% higher than $0.0522; is that what that indicates?
A. That's correct. One other -- this is a nuance and a pet peeve of mine. It's Land O'Lakes, not Land of Lakes. I'm sorry, but it's -- when you work for a company for 15 years and you hear it over and over again, it grates a little. So I just want to, if I could. I'm

sorry.
Q. I stand firmly corrected. Thank you. I have been admonished.
So -- but is it -- if -- is -- if I -- if I want to calculate the actual per pound cost of making butter at these two plants, with respect to processing labor, if I take $0.0522 and add to it 50% of 5.22, that will tell me the answer; is that right?
A. Yes.
Q. And so I'm not asking you to confirm this calculation, but I have calculated that to be $0.0783. Does that sound reasonable?
A. Ballpark.
Q. Okay. And similarly, when it comes to utilities, where you have in -- for butter costs of $0.0157, and you say that's your current actual 2002 Land O'Lakes cost, are 33% higher, you would simply add the $0.0157 plus 33% of 1.57 to determine what that number is, correct?
A. Correct.
Q. And once again, if I calculated correctly, that would give you $0.0209. I'm not asking you to confirm that number. But the methodology is correct, yes?
A. Ballpark, yes. It sounds directionally correct.
Q. Okay. All right. And you would do -- and similarly, when we get to nonfat dry milk, processing labor would be the $0.0362 indicated, plus 38% of -- of -- of 3.62, to get you the current Land O'Lakes processing labor cost, correct?

A. Correct. Yes.
Q. If I have to throw the word "labor" into the same sentence, I get really thrown off.
Okay. And similarly, to determine the utilities costs for nonfat dry milk, you would take the $0.0409 and add to it 36% of 4.09, and that would tell you what Land O'Lakes' current utility costs are for nonfat dry milk, correct?
A. Correct.
Q. And getting to the last entry, if one wanted to know what on a per pound solids basis Land O'Lakes' all other costs were, a number that reflects both butter and nonfat dry milk on a solids basis, one would take the $0.1009 and add to it 112% of 10.09 to know what that number is currently, correct?
A. Correct.
Q. And -- okay. Now -- okay.
And you did not do it here, but one could add up the five data entries in the Stephenson survey, correct? Just sum it -- I mean, literally just add $0.0522 plus $0.0157 plus $0.0362 plus $0.0409 plus $0.1009, correct?
A. One could.
Q. Okay. And I'm not asking you to confirm this, but at least my math would take -- would produce a number of $0.2459 just simple math. Okay?
A. Okay.
Q. And one could similarly apply the percentages that you have set forth in the fourth column -- excuse me -- in

the third column that reflects Land O'Lakes' actual costs adjusted with the various additions reflecting the percentages you have in that column, in the manner I have gone through, and then add up each of those numbers that -- correct?
A. Could you restate the question, please?
Q. Yes. I mean, for example, we talked about how if you -- to take the first number as an example, if you -- that assuming my math is correct, the process -- Land O'Lakes' processing labor costs as of 2022 are $0.0783, correct? Because that's what you get if you take the $0.0522 and add 50% of 5.22 to it, correct?
A. So -- so what you are saying is you could scale up all of the second column by the percentages in the third column and add them. You could do that.
Q. Yes. Okay. And that would be reflective of the increase on a percentage basis of the costs that -- that Land O'Lakes currently incurs as compared to what the Stephenson report reported back in 2007; is that fair?
A. You said current. It is as of 2022.
Q. With that correction, that would be correct?
A. I believe -- as I understand the question, yes.
Q. Okay. And, once again, I'm not asking you to confirm the number, but it would not surprise you, I -- would -- would it surprise -- start the question again.
I'm not asking you to confirm the number, but would it surprise you if by my calculation that would indicate a 70.26% increase in costs between the Stephenson

survey and Land O'Lakes' 2022 costs?
A. Insomuch as it's in between 112 and 33, it doesn't surprise me.
Q. Okay. And -- okay. And this, of course, is a study that focuses on two of the four commodities that are used to set minimum milk prices, butter, and nonfat dry milk, correct?
A. Correct.
Q. Okay. And we started the questioning with my statement that the -- not asking you to accept it, but my statement that IDFA's proposed ultimate Make Allowances, that's to say once they have been entirely phased in, is -- our view, I'm not asking you to accept it, but our view of what current costs to manufacture are. You understand that?
A. IDFA's proposal is your understanding of what current costs are, yes.
Q. Yes. And what -- and that is what the ultimate phased-in number reflects in IDFA's proposal, correct?
A. Understood.
Q. Okay. And do you know whether that -- with respect to butter and nonfat dry milk, IDFA's proposed increase in Make Allowances is actually lower than what Land O'Lakes is reporting as its cost increase?
A. I have not done that math.
Q. If you could turn to page 6.
A. Of the Stephenson survey or of my testimony?
Q. Sorry. Of your testimony, sorry.

Now, you have a sentence there, which you read into the record. I'll just repeat it for orientation purposes: "Cooperative members experienced these impacts" -- you're referring to reference -- actually, let me start the question again.

"Cooperative members experience these impacts through discounted milk prices going into their own plants to account for Make Allowances that are set too low, thus reducing current month milk checks or pricing the milk closer to or below class prices knowing there will be negative returns at their plants to be covered at the end of the financial year."

Do you see that?

A. I do.

Q. Okay. So when -- obviously, Land O'Lakes uses its own farmer milk to run its processing plants?

A. Correct.

Q. And as a handler, Land O'Lakes is technically required to account to the pool as that being the price it's paying for milk, the minimum Class III price, correct?

A. When pooled, yes.

Q. When pooled, yes.

And -- but you're not actually -- Land O'Lakes, like all cooperatives, is not actually required to pay that full amount to its farmers when it actually pays its farmers, correct?

A. Not required, correct.

Q. And that's typically referred to as reblending, correct?
A. As I understand it, yes.
Q. And so if I understand your sentence correctly, but tell me if I'm wrong, if the regulated price of milk is at a level that doesn't allow you to operate your plant at a profit, but instead at a loss, Land O'Lakes will reduce its actual payments to its farmers to cover that loss, correct?
A. It may.
Q. It may.
So it -- in effect, it's paying a price, you know, closer to or below the class price -- I'm using your language -- to make up for that loss, correct?
A. It may.
Q. It may.
That is not a -- that is not a power that a proprietary handler has, correct?
A. Closer to price, yes; below class price, no, as I understand it, when pooled.
Q. Okay.
MR. ROSENBAUM: That's all I have. Thank you.
THE COURT: Further cross, other than AMS?
CROSS-EXAMINATION
BY MR. MILTNER:
Q. Good morning, Mr. Edmiston.
A. Good morning, Mr. Miltner.
Q. I'd like to start with the data on page 3 of your

testimony that Mr. Rosenbaum went through.
A. Yes, sir.
Q. I want to summarize what I think I got from the question and answer with Mr. Rosenbaum, because I'm not clear on it, to be honest.
If you take -- I'm looking at the very first row -- well, the second row, processing labor under butter.
A. Yes, sir.
Q. Okay. If I multiplied .0522 times 50%, would that give me Land O'Lakes' actual processing labor costs -- processing cost increase for butter?
A. For 2022, as we reported in the Stephenson survey, yes.
Q. Okay. So you are starting with the number from Stephenson's survey?
A. Circa 2007.
Q. Right.
We're ending with LOL's actual costs?
A. Correct.
Q. Okay. Thank you.
A. Because the table is meant to show our actual costs have increased since the 2007 Stephenson survey.
Q. Great.
But we don't know -- well, what was -- what was LOL's processing labor cost in 2007?
A. That is not in the table.
Q. So your processing costs have increased 50% over

the 2007 reported number, but they may have actually increased something more or less than 50%?
A. I don't have that data with me.
Q. In the final row of that data under all other, the increase is, you know, substantially larger than for -- for the other categories listed.
Do you have a breakdown of the increases in each of the categories that are in all other?
A. Not that I would like to provide on the record, for proprietary reasons.
Q. Is repairs -- are repairs and depreciation the largest component of the increases?
A. I don't have that data with me. I don't have that data with me to answer that question accurately.
Q. If you had the data, would you share it?
A. As I mentioned -- well, no. As I mentioned, no.
Q. Okay. Did you compare or prepare similar data for your cheese operations?
A. We, can you define "similar data" for me?
Q. This -- the table --
A. This table specifically?
Q. Yes.
A. No, sir.
Q. Does Land O'Lakes process whey?
A. Yes, sir.
Q. Did you prepare a similar table for your whey operations?
A. No, sir.

Q. I'd like to ask about the Make Allowance survey that National Milk conducted of its members.

Do you know how many -- how many cooperatives participated in that survey?

A. I do not. The results and the participation were held from individual members.

Q. So they -- the results were withheld?

A. The -- I'm sorry, not the -- let me correct that statement. The detailed data within that survey and results such as, you know, individual co-op's responses were withheld from individual -- from the membership.

Q. Did they -- did they inform you about just the identity of the cooperatives that participated?

A. Not that I remember.

Q. So you don't know, for instance, if CDI's data was included in that survey?

A. No, I don't believe so. It's been six, eight -- well, it's been more than that. It's been many months ago, so I don't -- I don't remember seeing which individual co-ops responded.

Q. If we -- I'm just going to use butterfat to -- as an example. The butterfat Make Allowance that National Milk proposes is $0.21 per pound.

A. Correct.

Q. I understand -- correct me when I'm incorrect -- I understand that after these survey results were produced, or the results were provided to the members, that the task force or the participants then used that to come up with a

proposed Make Allowance for butterfat of $0.21; is that correct?
A. Correct. The survey provided the data basis on which the proposal resulted.
Q. Do you know what the actual butterfat survey number was? In other words, did the task force say, it's $0.25, but we -- we want to scale it down, as you described in your statement, and we're going to -- we now select $0.21. Do you know what that number was?
A. I don't off the top of my head.
Q. Was it provided to you by National Milk?
A. I believe so, but I do not remember.
Q. Do you know if -- do you know if any of National Milk's witnesses intend to share that information?
A. I -- I don't know.
Q. And I used butterfat as an example, but that generally would be the same for nonfat solids, protein, and other solids?
A. Correct.
Q. In terms of how the number was arrived at within the committee and -- well, in terms of how -- how the committee arrived at that number?
A. Correct. And I would say that, you know, as I mentioned before, it was a process of trying to balance impact to the producers and the data that we received. So my -- my recollection, I don't remember the exact number, but as I think through it, I don't believe the proposal was the exact number. I don't remember --

Q. Okay.
A. -- I'll be honest. I don't remember.
Q. Thank you. I appreciate that. In the testimony you provided a few days ago, you stated that Land O'Lakes' members own several cheese, butter powder, and value-added plants in the Upper Midwest, East, and California. You reference three plants specifically today.
Are there any other plants other than the three you mentioned which produce any of the surveyed commodities?
A. We -- we have four milk receiving plants. I referenced specifically in here Tulare and Carlisle, which are our two butter powder plants. We have Kiel that I reference in here specifically. Melrose is the only other milk receiving plant. It generally makes part Italian and specialty cheddar for internal use.
So to answer the question, I don't -- I'm not leaving anything out I think is how I interpret the question.
Q. Yeah. Melrose doesn't produce commodity cheddar, does it?
A. It -- not on a regular basis. Occasionally, it can, but it's for internal use, generally.
Q. Did Land O'Lakes supply any information about Melrose's costs to Dr. Stephenson or any other survey on Make Allowances?
A. Certainly not on whey. We don't make whey at Melrose. On barrel cheddar, I don't believe so. I'd have

to go back and check. In fact, I -- actually let me -- as I -- as I think through that, I'm pretty positive we did not. During the span of 2022, which was the time period the Stephenson survey would have covered, I don't believe we had any external sales of commodity cheddar for Melrose. So I believe the answer to that question is no.
Q. With respect to your plants at Carlisle and Tulare, I want to go through some products, and if you just let me know if they produce these products, if you could.
A. Sure.
Q. Salted butter?
A. Yes, sir.
Q. Unsalted butter?
A. Yes, sir.
Q. With respect to salted and unsalted, do they produce both in bulk and in quarters?
A. On a regular basis, no.
Q. What would they produce most on a regular basis?
A. Most on a regular basis is salted and unsalted quarters for retail. And salted bulk.
Q. There was some testimony, it may have even been from you, about how salted bulk butter is what a butter manufacturer will use to help clear the market.
Is that the case with Land O'Lakes?
A. Most of our butter is used internally.
Q. Okay. Do -- do either of those plants produce any other butter products, anhydrous or anything like that?

A. Tulare and Carlisle do not produce anhydrous.
Q. Do --do any Land O'Lakes plants produce anhydrous?
A. Hillsboro, Wisconsin, produces AMF.
Q. I'm sorry, what was the city?
A. Hillsboro, Wisconsin.
Q. Okay. On the powder side, Carlisle and Tulare, do they produce powders as well?
A. Yes, sir.
Q. Do they produce nonfat dry milk?
A. Yes.
Q. Skim milk powder?
A. Yes.
Q. Whole milk powder?
A. Yes.
Q. Buttermilk powder?
A. Yes.
Q. Any other powders that are of any significance there?
A. No.
Q. Do -- do your drying plants dry any whey?
A. Kiel.
Q. Of that -- that whey, is it -- is it dry whey? Do they produce --
A. Yes.
Q. -- dry whey?
A. Yes.
Q. Do they produce any WPCs?
A. Kiel does not.

Q. Does Hillsboro produce any WPCs?
A. No. It doesn't have a dryer.
Q. Okay. Does Land O'Lakes produce WPC at any other facility?
A. Melrose produces liquid WPCs.
Q. Turning to Kiel, does it produce 40-pound blocks?
A. Yes.
Q. 640-pound blocks?
A. Yes.
Q. 500-pound barrels?
A. No.
Q. Any other cheeses in significant volumes?
A. No.
Q. Do Carlisle or Tulare report sales to the NDPSR?
A. Yes.
Q. Do they report weekly?
A. Yes.
Q. And so am I right that they would only be reporting the bulk salted butter they produce?
A. Powders.
Q. Powders.
Do they -- do they report butter?
A. When we have sales that fit the criteria for NDPSR, absolutely.
Q. Is that a weekly report? Excuse me, that was a bad question. The report, of course, is weekly.
Does Land O'Lakes report butter on a weekly basis?
A. Comes and goes.

Q. Do you report nonfat dry milk on a weekly basis?
A. Yes.
Q. Do you report dry whey on a weekly basis?
A. Yes.
Q. Of the powders that are produced at Tulare and Carlisle, are you willing to offer a rough percentage as to how much of that is nonfat dry milk?
A. I don't have that data off the top of my head. I could give a -- I don't have that data off the top of my head. It would be guesswork, and I'm not willing -- I'm not super interested in doing that on the stand.
Q. Are you at least inclined to guess as to whether it is more or less than half?
A. I don't want to issue that guess.
Q. Okay. Do the plants at Carlisle and Tulare regularly run at capacity?
A. Define "regularly."
Q. Would you consider them a demand plant or a balancing plant?
A. Define "balancing plant." I'm not trying to be a jerk. I'm sorry. They -- a portion of the plant is clearly demand driven. I -- you know, I'll put it in this context. Our Tulare and Carlisle plants have the same dual mandate that the co-op has as a whole, to run a manufacturing operation as well as serve our producers. There are times when that means we have to respond to demand, more so on the butter side maybe than on the powder side.

But we absolutely have powder customers with, you know, exacting specifications and expectations for what we're going to supply, and we have long-term relationships that, you know, we don't necessarily want to damage. So there are times when we do both.

That's why it was a hard an- -- that's why it was a hard question for me to answer.

Q. Sure.
A. I wasn't trying to be difficult.
Q. Of Land O'Lakes' total manufacturing costs at Carlisle and Tulare, how much of that is attributable to unused capacity that's then allocated across the capacity that's actually utilized?
A. I don't have any calculation to delineate that out with me.
Q. I'd like to ask a question about a statement on page 5 of --
A. Okay.
Q. -- your current testimony. The paragraph -- second full paragraph beginning "cooperatives making commodity style products"?
A. Yep.
Q. Your statement that they cannot recover a larger margin on their commodity products, that's only true if you're looking at the commodity products that are actually surveyed by NDPSR, correct?
A. That is true of the commodity products surveyed by NDPSR.

Q. Wouldn't be necessarily true for whole milk powder, or skim milk powder, or the salted and unsalted quarters that make up the bulk of what Land O'Lakes produces, right?
A. What I believe you are saying is that the pricing of those products is not cycled back into NDPSR. Am I interpreting the question correct?
Q. Yes.
A. Then, yes.
Q. And when Land O'Lakes measures the profitability of its operations, does it do so on a whole unit, like an entire plant basis, or do you -- do you measure each -- each output separately?
A. Both.
Q. Has Land O'Lakes had to reblend to its producers in the past year?
A. I don't have the data to answer that question. And even if I did, I don't think I would provide it due to proprietary reasons for payments to our -- you know, the payment price to our producers.
Q. Okay. You -- I think Mr. Rosenbaum used the term "reblending," but you agreed that was a concept referenced in your statement, right?
A. That's how I understand the term to be used, paying below announced class prices.
Q. Okay. Then just to make sure I'm clear then. You -- for proprietary reasons you won't answer if Land O'Lakes has, in fact, paid below class prices?

A. I'm not willing to provide indications on our pay price to our producers for proprietary reasons, broadly.
Q. Okay. Thanks.
MR. MILTNER: That's all I have.
THE COURT: Okay. We have been going for about an hour and a half. Let's take a ten-minute break. Be back at 20 of. 9:40.
(Whereupon, a break was taken.)
THE COURT: Okay. Let's go on the record.
We have further cross-examination for this witness?
Mr. English.
CROSS-EXAMINATION
BY MR. ENGLISH:
Q. Good morning, sir. This is Chip English for the Milk Innovation Group, and I appreciate your appearance for Land O'Lakes.
A. Thank you, sir.
Q. So I only found a couple questions, I hope.
And the first is, Mr. Miltner asked you some questions about the National Milk survey, correct?
A. Correct.
Q. On page 3, you reference Stephen Cain as of the NMPF economist.
A. Yes, sir.
Q. And did an analysis of cost indices.
The way I read that sentence is that suggests that is different from the survey that you discussed with

Mr. Miltner?
A. Correct.
Q. Okay. And do you know the results of that analysis of cost indices?
A. I know the results. I don't have them with me as data. But directionally, they were -- you know, directionally relatively similar to the results of Dr. Schiek's work, although not as -- what term do you want to use -- not as -- not as high.
Q. Do you know whether his indices were adjusting from 2006 levels or were they using the CDFA data that Dr. Schiek used?
A. I believe he did both, if I remember correctly.
Q. Further down, just on that page, you say, "However, the ideal data that would be provided by a mandatory and audited survey does not exist today."
And we all agree that mandatory data doesn't exist.
Without that data, National Milk is, nonetheless, proposing that there be an increase in Make Allowances, correct?
A. Correct.
Q. So another -- another item that -- that National Milk and IDFA agree on is that even in the absence currently of mandatory audited survey data --
For those online, we had a bit of a power blip, and I don't believe I caused it.
But -- so another item that National Milk and IDFA

agree on is that not notwithstanding the fact we do not presently have mandatory audited surveys, there should be adjustments, correct?

A. Correct.

Q. So I want to turn just for a moment, I hope, to your testimony on page 7 about the impacts on producers. And this is the last full paragraph at the bottom of that page.

So first, you have a sentence that says, "Assuming implementation of proposed increase Make Allowances, dairy market supply and demand factors for milk and dairy products would likely mitigate some of the initial price impact on milk producers."

But then you say, further down, "Make Allowance increases larger than those proposed by National Milk will have a larger negative impact on milk producers' margins and increase the likelihood of jeopardizing the milk supply going forward."

Correct?

A. Correct.

Q. But you agree that over time markets will adjust to supply and demand signals, correct?

A. Correct.

Q. And your testimony, thus, recognizes that with those adjustments over time, declines in producer profitability will be adjusted, correct? It will account for that?

A. To some extent. I think that there is -- I think that there will be testimony later to -- that -- where analysis has actually been done to help define that.

Q. Okay. But if the IDFA proposal were to be adopted and the Make Allowances implemented -- staged over time, industry would have advanced knowledge of what those prices are going to be, correct?

A. Yeah.

Q. And with that advanced knowledge, wouldn't you expect the market to adjust supply and demand in stages based upon the knowledge in advance of what those Make Allowances will be down the road?

A. That makes sense, however, the statements that you read there, we're thinking more simply, along the lines of if you change Make Allowances by X, it is going to reduce producer prices by Y, and that's a certain amount of change that the market has to react to. If you change Make Allowances by X-plus, that reduces producer pay prices by Y-plus, and that's a larger thing for the market to have to react to.

Q. But what I'm saying is if it is done over time, it's X now, it's Y a year later, it's Z a year later, it's not additive immediately, correct?

A. Understood.

Q. And you agree?

A. Yes.

MR. ENGLISH: I have no further questions.

THE COURT: Further cross for this witness, other than AMS?

Seeing none, AMS.

CROSS-EXAMINATION

BY MS. TAYLOR:

Q. Well, good morning.

A. Good morning.

Q. Let me see. I have like three different question sources, so --

I wondered if you just elaborate a little bit on, from a Land O'Lakes perspective, exactly how you have dealt with inadequate, as you put them, Make Allowance levels. Like, how -- what has your co-op had to do?

I know you talk a little bit about, you know, your members have to -- I mean, the money has to come from somewhere, so basically it comes out of your member checks. But just wondering if you could elaborate on that a little bit?

Also, questions as -- I don't know if Land O'Lakes has this, but in the industry, some -- there's some cooperative supply management programs that are co-op based, if you all have those, etcetera.

A. Yeah. So, you know, as you mentioned, the need to adjust producer pay prices, that's become a lot more frequent. If you think about the last couple of years, the inflationary pressures on costs have been substantial, came on quick. And, you know, those weren't things that I think, at least in the last decade or two, we had experienced. And that required more frequent adjustments.

You know, any adjustment lower to producer pay prices is painful. Doing it more frequently is more painful. And that's kind of been the experience, I would say. It's been -- you know, the last -- call it the last two years. You know, I think it's been a good process to go through for us because -- in some ways because I think the communication required to help our producers understand the conditions we're facing as we try to run our plants but also maximize our pay price to -- and represent our producers the best we can, that communication process has been really helpful. But it's been tough.

Q. And on talking about deducts to producer checks to help cover that loss -- of course, I don't want any proprietary -- I'm not asking for any proprietary information. Can you talk a little bit about the length, the duration, the degree to which you have had to do that over time?

A. Well, it's ongoing. You know, costs are still changing. We're still running plants. And, you know, we still have financial obligations to meet as a business as well. And so as we try to balance those, I -- you know, the duration that you mentioned, you know, is not necessarily how we have looked at it. We -- you know, we have -- we have producers to pay, and we have a business to run, and we have to continue going forward to make sure that -- that we accomplish both of those things.

And so as we have communicated with our producers, you know, our obligation has -- has been to be as transparent as we can with them since they do own -- you know, they are the owners of our plants and our co-op, be as transparent as we can. But also try to create the understanding that conditions change and will continue to change, and we can't see the future, right, to understand exactly what our costs are going to do next and -- and what other adjustments to meet those obligations that we have might be required.

As you might expect, that uncertainty in and of itself is very difficult for producers, right, that are trying to run their own business and yet can't necessarily forecast what change might come next in their pay price as Land O'Lakes tries to balance, you know, that -- that dual mandate that I keep talking about between running our plants, running a business, and, you know, representing and doing the best for our farmers.

Q. And so would you -- can you talk a little bit about how that might -- I mean, we're talking about how it impacts their milk checks. But co-op members typically get a 13th check at the end of the year. So has this impacted that at all as well?

A. Absolutely. I don't want to give details on that.

Q. Sure.

A. But the answer to your question is an unequivocable yes.

Q. You talk about how Land O'Lakes and its plants, primarily I think Tulare and Carlisle, balance your member milk.

Do you also act as like the market balancer for any nonmember milk or other co-op milk and provide that service, or do you just have -- or are you just balancing your own member milk?
A. At times, we do. Day by day, week by week, the fact is not every plant's going to run perfectly. That's true of our plant. It is true of our customers' plants for the milk that we sell. It is true of other co-op plants. And so we do provide that, some of that service to our milk customers, as well as to other cooperatives over time, while balancing or producer milk as well, which changes every day and every week, too.
Q. Sure. Okay.
And your statement, of course, talks a lot about the balance approach that you and other National Milk members are trying to take when it comes to increasing Make Allowances.
But I -- I kind of -- I mean, if you are not proposing to increase makes to their full -- whatever the full level is -- and that number's up for discussion here -- but if we only increase the Make Allowances, you know, halfway, let's say, or whatever that number is, I mean, what's the consequence of that? How will Land O'Lakes deal with the fact that still the Make Allowances will not be reflective of your actual costs?
A. I would say it will be more of the same way in which we have dealt with it thus far. But, you know, I'll

refer back to that conversation, the specific conversation with a specific California producer that I had at a -- I believe it was last fall's -- fall's meeting, you know, in front of a good collection of our California producers. I, you know, was specifically told, don't go too far with this. Understand that we need to do it, but don't go too far with it.
Q. Uh-huh.
A. So I think that's what we're trying to do, trying to balance out impacts on producers as well as, you know, some of the effects of having Make Allowances, you know, be inadequate over time and that that's had on our manufacturing plants.
Q. So would you see any increase in makes -- would I -- I would assume would help positively be reflected on the balance sheet of the plant since it would be covering more of your manufacturing costs.
So would you see -- I would -- I would like you to talk -- then the second side of that is the impact to the producer milk check. Will that also be reflected on that side as well?
A. Yeah. I mean, relative to --
Q. Where they are now?
A. -- where they are now, yes.
Q. So less of a deduct?
A. Because of the change in the announced pricing.
Q. Right. Correct.
A. Yes. I want to make sure I was understanding the

question you were asking and getting at. Yes. Yes.
Q. What I'm trying to get at is it's kind of like a rebalancing --
A. Yes.
Q. -- on both sides of the equation?
A. Correct.
Q. Yeah. Okay.
You talked about what happens when Make Allowances are undervalued and the disorderly marketing conditions, and one of those points is the lack of investment in manufacturing plants. But then you did talk previously about how you have invested in your Kiel plant since the Make Allowance.
So I just wondering if -- I wanted to explore that a little bit, since you have invested in a plant, like how was that decision made? Is it -- what did that generally -- you know, what kind of investment did you make in that plant?
A. Yeah. So when you are running a co-op -- I keep going back to the time dual mandate. I'm sorry if I sound like a broken record, but it's the life we live, right? So we need to be able to keep processing producer milk. You know, that Kiel plant processes, you know, a little over -- today, processes a little over 3 million pounds of milk a day, and it needs to keep doing that, you know, as a way to serve our members, provide a market for their milk, and add value to their milk in the products that we make.

That plant had gotten to the point where it needed investment. You know, the vats needed to be changed. They needed to be replaced. The vats that we had had, had been in place for decades, and so we had to make that investment. And I think the way we would -- you know, the way we viewed it was a little bit of a yes or yes, sort of, alternative -- set of alternatives, right? So that's -- I think that's -- maybe that gives you a little bit of insight into how we went about that.

But -- but given Make Allowances, yeah, it was a -- it was a tough decision to figure out the right way to do it.

Q. And there's been discussion in the record earlier in this hearing about how there are new plants coming online, specifically, it seems like to do 40-pound blocks. And I'm just curious your thoughts on that. You know, we hear on one side --

A. Uh-huh.

Q. -- the inadequate makes means you can't invest. On the flip side there's new plants being built, so somebody's investing.

I mean, how are we supposed to square those two what seem like contradictory things?

A. Yeah. And I think our example of Kiel is a good one to use, in that, you know, I think it provides rationale that isn't necessarily just profitability of the plant that drives decisions. I think that there are -- you know, I can't necessarily climb into the heads of the people that are making those investments and tell you exactly what's in there. However, I think there are justifications for processing more milk that can be a significant contributing factor to some of those decisions, you know, as opposed to solely plant profitability.

Q. So put another way, maybe, the decision to not invest for a co-op, let's say, might be worse than investing, in that at least you have somewhere to put your milk?

A. Correct.

Q. On the bottom of page 4 you talk about how you try to maximize your plant throughput, and that includes producing commodity-style product, even though they have a smaller margin.

So we have a question as -- are you -- is it true then that maybe your product mix kind of drives that effort? You kind of decide how you are going to -- I'm trying to word the question in my head -- you have many options in a plant for what you are going to make, and so that decision on product mix kind of drives how much milk you put through that plant and where you can make money?

A. So I think this is actually a very similar question to what Mr. Miltner asked around, you know, are we demand driven or supply driven.

And the answer is yes. It's both. Right? There are times when we're absolutely demand driven and we have to live up to what our customers expect of the products coming out the back end of our milk receiving plants. And our producers also expect us to provide, you know, a home for their milk and value-added to it as we transform it from milk into products as well.

So we walk that balance each and every day. I'll give you an example. Yesterday at 4 o'clock I was here instead of being at a meeting where we decide for the next month or so what do we want to make at Tulare. And into those conversations, those conversations include our planning group, our operations group, our finance folks, milk -- you know, I represent the milk side of things -- and -- and then sales, as well, a key part of it.

On a monthly basis, we -- and even, you know, at times, even on a daily and weekly basis, we run that balance, figure out -- understand what our -- from sales what our customers expect us for, you know, butter and milk powder, understand what milk we have coming at us, and figure out how those two things fit together. It's done very, very regularly.

Q. Okay. And on the topic of your balancing efforts, can you speak to the plant's ability -- or how often then it runs at full capacity? I'm guessing, because you're a balancing plant, there are many times when it's not.

A. So the term balancing plant, to me, feels like it's a light switch, either it is or it isn't. And I would argue there are a lot of varying shades of gray to be balancing or not balancing. I think that's kind of what I'm trying to get at from, you know, answering

Mr. Miltner's questions to also answering the, I think, similar questions you are asking now.

And, you know, every spring our plants are full. And that part's easy, right? I think -- easy to predict maybe is the best way to put it. What's harder to predict is, you know, in plants -- plants generally try to make planned downtime in -- you know, in the summer months, into the early fall months when milk seasonally is lower. If a partner plant is down, if our plant's not running well, if milk comes in stronger than expected, there are reasons why we might -- we could still be full in August despite the fact that it's the seasonal low in milk production. So I guess, you know, my -- my answer -- my direct answer to your question is it depends.

Q. Are you sure you're not an economist?

A. I'm absolutely an economist.

Q. That's not your title, but I'm glad to hear that.

Could you expand a little bit on the impact to your cooperative producer members when you talk about the unfair burden that they have in trying to keep the plants running and balance the market, that you talk about other nonmembers do not have?

A. Yeah. So my view of that is, you know, partially as I state, you know, the ownership of the assets and the resulting returns, I would say that's the -- that's the clearest justification I would -- or rationale I would provide versus, you know, producers that -- that don't have that ownership in assets that are struggling to

maintain profitability.
Q. Do you think that that has had an impact on your -- some of your producers' ability to even stay in business?
A. Yes. Insomuch as we've had to make those continual adjustments, the impact that that has on milk price and the fact that, you know, we have seen producers exit the industry -- exit the -- exit the -- we have seen producers members exit the industry.
Q. On page 6 you have a chart there with Dairy Market News spot milk premiums and discounts. And in the sentence above that chart you talk about how this chart shows the effect of these discounts and the lack of investment on -- plant investment to process and balance milk supplies. And then you say, "As Make Allowances have fallen further behind actual commodities make costs, spot milk premiums have trended lower."
I was just wondering if you could expand on that and talk about how we should see that in this chart.
A. Yeah. So, you know, if you look -- it's faint, but there's a dotted trend line there. Right? That points downward. And it is meant to get at the idea, you mentioned the division of value between plants and producers. You know, I say elsewhere in my testimony that the effect of Make Allowances that are too low is essentially to overvalue the milk. I view these spot premiums as reflective of the market's attempt to do some of that balancing to offset what is currently milk that's

overvalued as a result of Make Allowances that are too low.
Q. So the market doesn't have the ability to offer premiums because that money has to go towards the manufacturing cost side of things.
A. Less and less over time, and it's resulted in less investment in manufacturing assets.
Q. Okay. I want to talk a little bit about your point 3 on page 7, about increasing Make Allowances too high and too fast is basically what you are getting at.
A. Uh-huh.
Q. And you talk about how that would be very disruptive to dairy producers. I wonder if you could elaborate on that.
A. Yeah. I mean, you know, as we saw -- I provide a little bit of color commentary in here around producer profitability. I think you will see a lot more here from other -- other witnesses over the span of the next couple of days. But, you know, if you are already seeing some producers that are struggling to make it and you lower milk price, right, the natural consequence is, you know, you will -- you will see further strain in terms of producer profitability.
Q. And if I can take that one step further. Are you saying you will see an increase in producers going out of business?
A. I think if you lower the milk price, that's a natural consequence.

Q. Below you talk about how after "implementation of the proposed Make Allowance increase, the dairy market and supply demand factors for milk and dairy products would likely mitigate some of the initial price impact on milk producers."

Can you talk a little bit about that, how when that happened, how would we see that?

A. Yeah. I mean, I'll just go back two questions to when we covered a little bit of the spot milk premiums. You know, I think the market finds its own way -- find its way to at least attempt to -- to balance supply and demand. And so a change here, you know, won't -- a change in Make Allowance won't necessarily change that effort on the part of markets. I think there will be more -- you know, as I mentioned before, I think there will be another witness here soon that's done a lot of analysis around the potential market adjustments over time that will provide better detail on that than I will, numerically.

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

THE COURT: Anyone else?

Mr. Cryan.

CROSS-EXAMINATION

BY DR. CRYAN:

Q. Roger Cryan for American Farm Bureau Federation.

I apologize, I was really going to let this go, but Ms. Taylor asked some questions, and especially about cheese plant construction.

You have talked about some of the other reasons co-ops had for continuing to build cheese plants under the current Make Allowance regime.

But it's not only co-ops building cheese plants at this time, is it?

A. And not only co-ops put producer milk into plants.

Q. Beg your pardon?

A. Not only co-ops put producer milk into plants. So just --

Q. Co-ops aren't the only ones that are building cheese plants, right?

A. Correct. But -- but the plants that are being built also take producer milk.

Q. Of course.

A. So the same driver of -- you know, that co-ops might face to build a plant, process milk, process more milk, could be experienced by non-co-ops as well, because there are also producers that put milk into those plants.

Q. But a non-co-op plant doesn't have any obligation to the producer as the co-op does?

A. Not the same structure.

Q. Right. And I mean -- so there's some return to the non-co-op manufacturers that are continuing to build plants; would you agree?

A. But that -- yes, but that return may be at the plant level. It could be at the producer level.

Q. Okay. And -- and I think you have said that there continues to be -- I think it's been repeated -- there

continues to be uncertainty about industry costs in the absence of a mandatory audited survey?
A. Correct.
Q. Okay.
DR. CRYAN: Thank you. Thanks very much.
THE COURT: Any other cross or re-cross?
Seeing none, redirect.
MS. HANCOCK: Thank you, your Honor.

REDIRECT EXAMINATION

BY MS. HANCOCK:
Q. Thank you for your time so far today, Mr. Edmiston. I just have two brief items to follow up on.
You have received some questions about the increasing costs that have been estimated by you and I guess amalgamated for your plant -- all of your plants, for at least your butter and nonfat dairy milk.
Do you remember that?
A. Yes.
Q. Is it fair to say that you have some plants that are newer than others?
A. Yes. And I would say some portions of some plants that are newer than other portions of the same plant.
Q. And as you update your processing plants, is it fair to say when either you are updating those plants or you're building new plants, you are really looking at building in efficiencies in the cost of producing whatever final product it is?

A. Absolutely.
Q. And so the goal is the more efficient you can make your processing, the more profitable you can actually be as a business?
A. Absolutely.
Q. And is it fair to say that as time has gone on, you have been able to improve some of those processing efficiencies such that you can make a product for less than -- than what the otherwise growth trajectory has been for input costs?
A. Can you restate that, please?
Q. Yeah. Have you been able to build in efficiencies as you have been able to either update plants or build your new plants?
A. Yes. We try -- you know, any investment we -- any investment we make in our plants, we're trying to do that for sure.
Q. And if you can beat the Make Allowance in your actual cost, it just assists you as a processor because it adds to your margins; is that right?
A. Absolutely.
Q. When you have a Make Allowance that's been established, it becomes kind of a watermark line for you as a processor to try and beat that market?
A. Absolutely.
Q. And you had also had a couple of questions about as a cooperative you have an ability to reblend, whether you do or not; is that fair?

A. Correct.
Q. I'm just wondering if you could talk about, as a cooperative, you have a dedicated membership that you are supporting of dairy producers; is that right?
A. Yes. And -- go ahead.
Q. With that, does that come with some responsibility that you are obligated to take the milk that your dairy producers produce for you?
A. Yes. Our commitment to our producers is to -- is to take their milk. And so while they are -- you know, while we have an ability under the letter of the law to reblend, we're also held to task by our producers to pay as -- both pay as much as we can, but also -- and be as efficient as we can, as you have said. But also, you know, to take all their milk every day, every week, and provide that balancing, both to the -- both to whatever milk may come off the farm, but also to making sure we find a home for all that milk.
Q. Okay. And do you also have responsibilities to balance the market as well?
A. Yeah. I mean, you know, as I mentioned a little bit, you know, we have got milk customers whose plants may not run perfectly. We have got our plants that may not run perfectly. And we have got, you know, other co-op partners whose plants may not run perfectly. And so that balancing responsibility is absolutely something that we -- a responsibility that we as a co-op have.
Q. So while you might have some opportunities to

reblend if necessary, you also as a cooperative have some responsibilities that proprietary plants don't have; is that right?
A. There's a responsibility that goes along with it, yes.
Q. Because a proprietary plant, for example, doesn't have to take all the milk of the producers that --
A. May or may not.
Q. -- they are delivering?
A. May or may not.
Q. All right. That's all I have.
MS. HANCOCK: Thank you, your Honor. We would move to admit Exhibit 144.
THE COURT: Any objection?
Exhibit 144 is admitted into the hearing record.
(Thereafter, Exhibit Number 144 was received into evidence.)
MS. HANCOCK: Thank you.
THE COURT: Mr. Rosenbaum?
MR. ROSENBAUM: Your Honor, we would move Hearing Exhibit Number 145 into the record.
THE COURT: Any objections?
Exhibit 145 is admitted into the record.
(Thereafter, Exhibit Number 145 was received into evidence.)
THE COURT: Thank you, Mr. Edmiston. You are -- you may step down from the stand.
Who is next, Mr. Rosenbaum?

MR. ROSENBAUM: Your Honor, the next witness will be Mr. Steve Schlangen.

THE COURT: Thank you.

MR. ROSENBAUM: And, your Honor, he has two statements addressing two different proposals, and so I will -- will provide the copies of both.

THE COURT: Thank you.

Raise your right hand.

STEVE SCHLANGEN

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

DIRECT EXAMINATION

BY MR. ROSENBAUM:

Q. Good morning, Mr. Schlangen. We've put before you two documents. One of them is titled IDFA Exhibit 25.

And is that your testimony with respect to the Make Allowance proposals?

A. Yes, sir.

Q. Okay. And we have also put before you IDFA Exhibit 36.

And is that your testimony relating to the proposal whether to exclude barrel cheese from the survey?

A. Yes, sir.

Q. Okay.

MR. ROSENBAUM: Your Honor, I would ask that these exhibits be marked with the next two Hearing Exhibit Numbers.

THE COURT: Yes. Exhibit IDFA 25, top right-hand corner, will be marked 146.

(Thereafter, Exhibit Number 146 was marked for identification.)

THE COURT: IDFA Exhibit 36, top right-hand corner, would be marked 147 for identification.

(Thereafter, Exhibit Number 147 was marked for identification.)

MR. ROSENBAUM: Thank you.

BY MR. ROSENBAUM:

Q. Mr. Schlangen, could I ask you to go ahead and read what's been marked as Hearing Exhibit 146 into the record?

A. Yes, sir.

Well, good morning. I'm Steve Schlangen. I'm a dairy farmer from Albany, Minnesota, and I'm chairman of the Board of Associated Milk Producers, Incorporated.

My comments are on behalf of 800 fellow dairy farmer-owners and focus on our cooperative priority of updating Make Allowances to reflect the cost of processing milk into dairy products.

For context, a bit about my farm and the cooperative in which I'm an owner.

My wife Cheryl and I milk 60 cows with a robotic milker and farm 200 acres of land. We began our dairy farming career in 1986, buying a small herd of cows and renting a barn on the farm we now own. AMPI was there to help us when we got first started, and we've been members ever since.

The co-op is headquartered in New Ulm, Minnesota, and is owned by dairy farm families from Wisconsin, Minnesota, Iowa, Nebraska, South Dakota, and North Dakota. We are the largest farmer-owned cheese cooperative in the United States.

Our cheese, butter, and powdered dairy products are produced at eight manufacturing plants located throughout the region, and then marketed to foodservice, retail, and food ingredient customers.

AMPI supports proposals to update manufacturing allowances to 2022 levels. Over the past two years, the dairy farmer-owners and employees of AMPI participated in committees examining needed Federal Milk Marketing Order updates through the International Dairy Foods Association, the National Milk Producers Federation, and the Wisconsin Cheese Makers Association.

We are amid a once-in-a-generation opportunity to reset the Federal Milk Marketing Order system. The opening page of the USDA AMS Federal Milk Marketing Order website states the intended purpose of Federal Milk Marketing Orders.

And I quote, "Federal Orders serve to maintain stable marketing relationships for all handlers and producers supplying marketing areas. Thus, facilitating the complex process of marketing fresh milk."

The first step of fulfilling this mission is determining the minimum milk price for the four classes of milk utilization. In other words, Federal Orders determine the minimum values for all milk -- all milk pooled under Federal Orders.

To accurately determine these milk values, the system must reflect current manufacturing costs for milk and require regular updates to reflect both changes in costs and efficiencies.

Today, the milk price regulations are outdated and increasingly irrelevant. Void of any updates since 2008, the current manufacturing milk calculations do not reflect today's costs. Simply put, it has become a system built on bad math. This is detrimental to dairy manufacturers and farmers alike, disregarding the basic purpose of the system, providing the stable marketing relationships as described on FMMO website.

Make Allowances are an estimate of dairy processors' costs of converting milk into dairy products. Many of those production costs, including labor and energy, have skyrocketed since Make Allowances were last updated in 2008. Capital and operating costs have increased significantly in 15 years.

As a dairy farmer and owner of eight manufacturing facilities through AMPI, I have witnessed the repercussions of outdated Make Allowances. When underestimating processing costs used to determine Federal Order Milk component values, inaccurate price signals are sent to the marketplace and may lead to the misallocation of capital and resources.

Make Allowances are important as they drive all minimum milk prices. The impact of these overvalued minimum prices is drastic. Milk market premiums have been replaced with significant price reblends below regulated minimum prices across much of the country.

Most U.S. cooperatives have instilled production limits, as inadequate manufacturing capacity is not meeting many dairy farmers' desire to grow their business and be cost competitive.

To quote Tanner Ehmke, former lead dairy economist for CoBank, "Inadequate Make Allowances may lead to underinvestment in dairy processing facilities or result in over-investment in low-cost plants. Ultimately, that could result in limited market access for U.S. dairy products and allow international export competitors to meet the rising global demand for high-value dairy products."

To facilitate a timely update, the 2023 Cost of Dairy Processing survey tool was launched by Dr. Mark Stephenson. He has worked on production costs for manufacturing plants from cheese to fluid milk for decades. His work includes previous cost surveys for USDA in 2006 and in 2021. The 2021 survey, published last year, included mostly 2018 costs.

Recognizing the large shifts in capital and operating costs for their members over the past few years, IDFA and WCMA funded the update to Dr. Stephenson's most recent survey of 2022 cost data completed this spring. AMPI participated in that survey, submitting costs for multiple products from our four cheese manufacturing facilities and one nonfat dry milk plant.

Dr. Stephenson used a computer survey process to collect the information, very similar to his earlier approaches. He also changed cost allocations back to a per solids basis as a standard practice for most of the industry, and the method used in his 2008 survey, and the well-regarded California Department of Agricultural audit surveys.

Dr. Stephenson collected cost information from 18 cheddar manufacturing plants across the country. These plants produce an average of 122 million pounds of cheddar cheese annually, well above the average cheddar production per plant in this country. Even with significantly larger plants included in the survey, Dr. Stephenson's 2023 cost survey results were significantly higher than current cash -- current Make Allowance levels.

The 2023 survey found an average cheddar manufacturing cost of $0.2643 per pound, more than $0.06 higher than the current Make Allowance. Average whey manufacturing costs averaged $0.3361 per pound, $0.137 higher than the current make of $0.1991 cents.

IDFA and WCMA also commissioned a study to project 2022 costs based on the audited California cost surveys from 2002 through 2016. Dr. Bill Schiek found the projected 2022 costs for cheddar cheese were $0.3006 per pound and for dry whey was $0.2953 per pound.

As the largest cooperatively-owned cheese company in the U.S., our costs of processing per manufactured pound clearly illustrates the outdated Make Allowance. I'll share these today through percent of change to protect proprietary information. The change is calculated from the cost of processing per manufactured pounds in fiscal year 2022, December through November, compared to fiscal year 2008. The years are significant as it reflects the same period since Make Allowances were last updated.

The high level percent change for AMPI bulk cheese products is 47% higher in 2022 than it was in 2008. General plant expenses are up 62%.

Since the last Make Allowance update in 2008, cheese making equipment to facilitate fat recovery has been installed in each of AMPI's major cheese plants. Despite these capital investments in increased yield and plant efficiencies, AMPI's cost to convert milk to cheese still increased immensely.

Though some caution, a 15-year leap in Make Allowance values will hurt U.S. dairy farmers, AMPI contends it brings about more orderly marketing conditions -- more orderly marketing conditions and better reflects the relative value of all products. It also puts regulated milk costs in greater alignment with the prices paid by the many unregulated competitors we compete against for product sales every day.

Experience in our plants more than justifies the proposed increases immediately. Some are proposing any changes in Make Allowance or other pricing be further delayed, giving futures markets time to adjust to the Make Allowance changes. In our view, any delay will magnify an already disorderly marketplace.

Moving forward, AMPI supports most industry organizations in updating Make Allowances through mandated audited surveys. These updates must happen to avoid the current misalignment of actual costs with Make Allowances.

Thank you for the opportunity to underscore the need to update Make Allowances and restore credible Federal Milk Marketing Order system. The dairy farmer-owners of AMPI believe the system should be built on real numbers. We look forward to the day that Class III numbers truly reflect the value of milk for cheddar manufacturing.

Q. Thank you very much, Mr. Schlangen.

Can you please turn now to your other statement, which is Hearing Exhibit 147. I believe you can skip the first five paragraphs on the first page because those are duplicative of the paragraphs you have already read, and then if you could start with the paragraph that begins with "AMPI opposes Proposal 3."

A. In addition, I want to draw your attention to AMPI's opposition to Proposal 3, which would remove barrel cheddar prices from the Federal Order Class III protein formula.

As both a block and barrel cheddar manufacturer, AMPI recognizes the unstable relationship between block and barrels prices in Class III has caused a variety of problems for the industry. We believe, however, that eliminating barrels will increase more volatility for barrel manufacturers and compromise their competitive position for milk.

Moving Class III to 100% block weighting would complicate milk pricing for manufacturers making barrel cheese. Barrels produced in the U.S. are almost always priced based on a CME spot barrel price, while Proposal 3 would essentially disconnect Class III milk pricing from the CME barrel price. The resulting disconnect between revenue and the Class III milk price could increase margin volatility and the ability to compete for milk.

AMPI competes for sales with barrel manufacturers operating both inside and outside the Federal Orders. Unregulated manufacturers must still compete with other manufacturers for milk in the local markets, but their profitability will not be directly impacted by regulated minimum prices, just market competition for milk.

Supporters of removing barrels from the NDPSR cheese price, including some Midwest barrel manufacturers, believe the market price for barrels could move in -- move to a block basis. Removing barrels from the NDPSR cheese price by no means guarantees the CME will remove the barrel cheddar spot market from its daily market offerings.

The CME makes changes to its market offerings based on market demand, and there's no reason to expect barrel manufacturers and buyers will agree to shift their pricing to the block market. Barrel buyers will want to be assured their costs are aligned with the commodity market for barrel cheese. Using the barrel cash market as a pricing reference point provides that assurance.

AMPI believes the primary reason to continue including blocks and barrels in the NDPSR cheese price is that both have comprised a total supply and demand picture for cheddar cheese. They are traded commodities at CME cash markets and, thus, have an openly-traded market to determine value. Combined, they provide a picture of the commodity cheddar market. AMPI is a major manufacturer of both block and barrel cheddar and believes a combination of the two provides the best indicator of overall market conditions.

AMPI recognizes there has been growth in barrel capacity in the Midwest over the past few years. Some barrel processors added the capacity to make block cheddar to best meet market demand for the variety of products they make. This capacity has been needed in a year like 2023, where milk supplies in some markets, particularly in the Upper Midwest, exceeded processing capacity. It is hard to view capacity of any type of cheese as "surplus" when it was needed to clear markets of excess milk.

Q. So in summary, is it -- based upon the titles of your two testimonies, which I did not ask you to read, but based upon those summaries, AMPI supports Proposals 8 and 9 and opposes Proposal 3; is that accurate?

A. Yes, sir.
Q. Okay.
MR. ROSENBAUM: The witness is available for cross-examination.
THE COURT: Who has cross for this witness?
CROSS-EXAMINATION
BY DR. CRYAN:
Q. I'm Roger Cryan for the American Farm Bureau Federation.
Good morning, Mr. Schlangen, how are you? Nice to see you again.
A. Pretty good.
Q. Are you a Farm Bureau member?
A. Yes, I am.
Q. I'm proud to hear that.
I would like to touch on a point of agreement, what I believe is a general point of agreement, because I think it's worth bringing it up repeatedly.
Ultimately, we both agree that the -- in the long run, the best solutions are to have mandatory audited surveys to -- to have the clearer measurement, clearer data in order to -- of cost to yields in order to set these Make Allowances; is that right?
A. I think that is a good thing they should shoot for in time. I think we have pretty good information as to right now to make some adjustments. And it's something we should have probably had ten years ago, was the survey prices, to get good information to make those adjustments,

and then we would have never got to this situation where we're short of marketing -- we're short of capacity, and we're dumping milk.

Q. I think we all agree it would be nice if we had done that ten years ago, if we had pushed for the legislation we're pushing for this year.

I'm sorry, I'm going to ask you one more question because I guess I hadn't really appreciated the barrel statement.

But it's my understanding, AMPI has taken -- taken steps and gone to some lengths to try to balance your block-barrel mix to match the mix in the price survey in order to avoid being hurt as much as possible by the -- any imbalance in the survey; is that right?

A. Well, we try to do whatever we can to be able to process our members' milk and find a market for the products that we process them into. And, yeah, we try to do what we can in our plants to -- to make that happen.

Q. Very understandable. I appreciate that.

DR. CRYAN: Thank you very much for your time.

THE WITNESS: Thank you.

DR. CRYAN: Thank you.

THE COURT: Thanks.

Mr. Miltner.

CROSS-EXAMINATION

BY MR. MILTNER:

Q. Good morning, Mr. Schlangen.

A. Morning.

Q. My name's Ryan Miltner. I represent Select Milk Producers.
I would actually like to start with questions on your second statement, Exhibit 36, if I could.
You're testifying today on behalf of the cooperative, correct?
A. Right.
Q. Okay. You write in your statement that "we" -- AMPI -- "is the largest farmer-owned cheese cooperative in the U.S."
Can you describe for me what you mean by "cheese cooperative"?
A. Well, we are a dairy farmer-owned business that produces cheese.
Q. Are there other cooperatives, dairy cooperatives, that you would consider cheese cooperatives?
A. I would say there are.
Q. Okay.
A. In the Upper Midwest probably, more so.
Q. Who would you consider to be a cheese cooperative like AMPI?
A. I would consider First District Association, Bongards Creameries, Ellsworth. Most of the folks in our Upper Midwest.
Q. Is AMPI a member of IDFA?
A. Yes, we are.
Q. Are you also a member of National Milk?
A. Yes, we are.

Q. Was AMPI a member of National Milk's task force on Federal Order Reform?
A. Yeah, we had a number of people involved in the task force. And I was on the economic policy committee.
Q. Did you also have people involved in a similar group with IDFA?
A. Yes.
Q. Were the same people on both committees?
A. I would say not totally. I don't -- I couldn't say for sure.
Q. Okay. At the top of page 2 on Exhibit 36, you write that: "Proposal 3 would essentially disconnect Class III milk pricing from the CME barrel price."
How does the CME barrel price right now factor into Class III?
A. Well, the barrel price is a big part of the formula of cheddar cheese produced in the country, and that's not going to just go away. I think this started a number of years ago, and we talked about it at National Milk, that the barrel price was oftentimes understated or it was -- to the point it actually -- because of the products that were getting sold on that barrel market, it didn't really reflect the value of barrels, really, because a lot of those products were not up to the standards that someone that was buying them would like them to be.
So I think that if there's any way to -- to drive a market down, the best thing to do would be to offer

something that nobody wants to buy. So instead of taking care of that problem and working on that, I think the idea to get away from barrels in the formula was the next best thing.
Q. I guess my question -- and I perhaps didn't phrase it as precisely as I should have.
The NDPSR barrel price feeds into Class III, correct?
A. I believe so. I -- I really don't know all the details of that all. I can tell you that.
Q. Okay. If -- if barrels were not part of the Class III formula, are you concerned that the CME would discontinue offering barrels on the spot market?
A. I wouldn't -- I wouldn't worry about that. I think it's the most highly traded product on the CME, and that's what they would continue to do is to trade that. But it wouldn't be connected to, you know, the price of the Class III that we're trying to find a discovery price for manufactured milk, and if you disconnect the barrel market, you disconnect a big chunk of what is getting made into cheddar cheese in this country.
Q. The answer you gave a little bit ago, were you suggesting that the barrel price was depressed because of low quality barrels that were put on the market?
A. I don't know if I would say they are low quality, but they are probably the quality that we, as a maker of processed cheese, would rather not use.
Q. Do you have any thoughts as to why barrels of that

quality appeared on the market?
A. I couldn't say for sure. It's probably because of processes that manufacturers of those barrels use to make products. I don't know.
Q. Are you aware of any barrel manufacturers that produce clean whey and perhaps view that as their primary output, with the barrel as the byproduct?
A. I couldn't say that I know that as happening. I know what we produce is we produce barrels, and the byproduct is a white whey that can be used probably in more -- maybe higher value products than, say, your colored whey out of a block plant where you make colored cheese. But I couldn't say that that's what people are doing.
Q. In your experience, does that clean whey command a higher value on the market than colored whey?
A. I would -- I guess I wouldn't know that for sure. I would think that it might, but I guess I wouldn't know that for sure.
Q. You mentioned that AMPI is a major manufacturer of both block and barrel cheddar.
The blocks you produce, are they 40-pound blocks?
A. No, we produce 640s.
Q. Okay. Only 640s?
A. 640s, yeah.
Q. At the end of your second statement you state that milk supplies in some markets, particularly the Upper Midwest, exceeded processing capacity.

Was there milk actually being dumped in the Upper Midwest?
A. Yeah. Yes, there was. A lot of it. And if there's one thing that makes a dairy farmer sick, is going through all the work and it -- the money to produce that milk, knowing that there's starving people around the world, and we have to run it down the drain, because that is the most economical answer to do with that milk at the time.
Q. I have heard that from several farmers that I know, and when it occurs, it is tragic.
Do you have an estimate as to how often that phenomena occurs in your part of the world?
A. You know, it happened more this year than I remember in the past. From a number of situations, I think around the country, you know, we had record milk prices last year, which always leads to more production. We had milk in parts of the country where the manufacturing wasn't in place yet to handle that milk, and that got hauled up into our region and, you know, took away some of the outside sales there. So there's a lot of things that affected it this year, probably more than other years.
But, yeah, it was a big deal this -- this winter, through the winter and into the spring.
Q. When that occurs, is AMPI able to purchase spot milk at substantial discounts to Class III?
A. When that occurs, AMPI has way too much milk, and

we're selling that milk, we're almost giving it away, because there's no market for excess milk.
Q. Who -- who would be your buyers in that situation?
A. For the excess milk?
Q. Yes, sir.
A. I guess I wouldn't know exactly who they are. We have a number of customers that we sell on a regular basis because we probably have 15% of our milk that we would sell off as fluid into a Class III market or to a bottler, where about 85% of our milk generally goes through our plants.
So we have a number of customers, but, I mean, when you get in that situation, you are going to sell milk for whatever you can get for it until you get to a point where it's like -- would be more cost effective to open the valve and run it down the drain.
Q. I'm turning now to your other statement.
THE COURT: 147?
MR. MILTNER: I'm sorry?
THE COURT: 147?
MR. MILTNER: No, this would be 146, I believe.
THE COURT: Okay. His first one.
MR. MILTNER: His first statement.
THE COURT: Thank you. Sorry.
MR. MILTNER: That's okay.
BY MR. MILTNER:
Q. Were you part of the National Milk task force or working group that submitted surveyed cost data to help

develop Proposal 7?
A. I was not on the task force.
Q. Do you know if AMPI submitted cost data from its plants to the National Milk survey?
A. I believe we did. Is that the Stephenson survey?
Q. No. This -- this would be the survey that National Milk conducted among its group to develop the numbers in their Make Allowance proposal.
A. I assumed those numbers came from the Stephenson survey from 2018, concluded 2021 or '22.
Q. Okay.
A. I believe that's where those numbers came from.
Q. You are not aware of AMPI giving numbers to anybody other than Dr. Stephenson?
A. That's who we have worked with in the past, yes.
Q. Okay. By the way, I do like your line that says the regulations have become "a system built on bad math." I don't necessarily agree with that, but the only other time I have heard that description is when someone described Las Vegas.
At the top of page 3 you say, "Most U.S. cooperatives have instilled production limits, as inadequate manufacturing capacity is not meeting many dairy farmers' desire to grow their businesses and be cost competitive."
I'd like to understand how you draw that conclusion. How -- what leads you to make the conclusion that inadequate manufacturing capacity has triggered base

programs?
A. I don't get what you mean.
Q. Well, you say that the base programs are a function of inadequate manufacturing capacity, and I'm just curious as to why and you how connect those two in that way.
A. Well, that's -- it's how it's worked for us. It's how it is working with others that are competing against us in our region that have those plans in place because they have to control that production because there's no home for some of that -- that excess milk because of all the years of the Make Allowance being outdated and us reducing -- getting rid of our balancing plants and getting rid of our outdated or inefficient plants, just to be able to hang in there and live in the world we live in with these outdated numbers on the Make Allowance.
Q. That's AMPI's experience, correct?
A. Yes, it is.
Q. You don't know necessarily if other cooperative base programs were motivated by a different reason, though, do you?
A. I don't. Right.
Q. You also quote the dairy economist for CoBank, and I'd like to understand. The first sentence of that quote reads: "Inadequate Make Allowances may lead to underinvestment in dairy processing facilities or result in overinvestment in low-cost plants."
I'd like to understand why inadequate

Make Allowances would lead to overinvestment in low-cost plants.
A. That's actually a good question. I guess I don't know the answer to that, either.
Q. Do you know what Mr. Ehmke meant by "low-cost plants"?
A. I don't. I could assume it might be some kind of a plant that would part -- remove part of the milk value just to get something out of it, and then relocate it to a buyer.
Q. Were you in the room this morning when I asked Mr. Edmiston about Land O'Lakes plants?
A. I was for most of it, yeah.
Q. Okay. I want to ask similar questions about AMPI's plants. So, although I don't have the page right, I don't think I'm turned to the right page, but did you say that AMPI had eight facilities?
A. We do have eight facilities.
Q. Are those all cheese plants?
A. No, they are not. We have four cheddar plants. We have one powder plant. We have a butter plant in New Ulm, Minnesota. And we have a further processing -- it's a re-packaging, packaging plant in Wisconsin. And we actually have one small cheese plant in South Dakota.
Q. Let's start with the small cheese plant in South Dakota.
Does it manufacture 40-pound blocks?
A. No, it does not.

Q. Does it manufacture barrels?
A. No, it does not.
Q. Does it handle its own whey?
A. We have -- no, we don't process our own whey. We find a market for that. It's an Italian-type cheese plant. It's small. It's old. It's made some of the best cheese in the country, been a winner at National Milk in the best parmesan cheese in the country a couple of years in a row. But it's a very small plant. It's very labor intensive.
Q. Produces more of a specialty cheese?
A. Right.
Q. Your re-packaging plant, does that do what I would expect it to, it takes products produced somewhere else and repackages them for further distribution?
A. Right.
Q. It doesn't manufacture, itself, any commodity products?
A. We don't take any milk into that plant, right.
Q. You mentioned a butter plant and a powder plant.
Are those two separate facilities?
A. Right.
Q. Does your butter -- well, what products are produced at your butter plant?
A. The butter plant is really a packaging plant for either churning butter and making quarters and solids, and cups and different things for retail and foodservice, or we -- we buy bulk butter and re-package it in there -- in

there also.
Q. You are taking bulk butter and reworking it to quarters or something like that?
A. It depends on the season, yeah, and the cost of cream, things like that. You know, you try to get the best -- the best -- you know, to get the best return out of whatever you can sell those butter products for.
Q. We won't talk about cream multiples, unless we have to.
A. Well, you can. But I mean, when they get too high, we -- ice cream people buy them. And -- you know, but that's -- that's part of the equation, is when butter multiples are at a good level that are attractive to us, that's when we run our churns and we put through as much through our churns and make quarters or bulk butter even then, just to cash in on that market.
Q. Okay. AMPI will -- will change what it produces and what it does with cream in order to maximize the returns to its owners, correct?
A. That's what I think I meant in the first place, yes.
Q. Okay. So your butter plant does not produce bulk salted or unsalted butter?
A. I think we do produce some bulk salted and unsalted for certain customers.
Q. Do you know if the manufacturing cost information for that butter plant was reported to Dr. Stephenson?
A. I don't know that. No. I know that in the last

survey it was our four cheese plants and it was our powder plant.
Q. Okay. Your powder plant, does it produce nonfat dry milk?
A. Actually, yeah. It's in South Dakota. It produces the high-heat nonfat dry milk, which is a higher value powder used with -- for a lot of bakeries.
Q. Does it produce low-heat nonfat?
A. I don't believe we do. I couldn't say for sure.
Q. Does it produce skim milk powder?
A. I don't believe so.
Q. Whole milk powder?
A. Yes.
Q. Does it produce buttermilk powder?
A. I don't believe so.
Q. Does it dry any whey?
A. No.
Q. So its principal product is high-heat nonfat dry milk?
A. Correct.
Q. And your understanding is that plant did report its costs to Dr. Stephenson?
A. I believe it did on the powder side. The cream is separated off on the milk, and that -- that cream would go to our New Ulm plant for the butter manufacturing there. But I believe it's just the powder side that was reported.
Q. Do you know what happens to the buttermilk at your butter plant?

A. That also probably gets dried somewhere. We have capacity at our Jim Falls plant to do some of that. Again, a lot of things depend on markets and the demand for different products, so if you sell them as a liquid or if you would dry them and sell them as a powder.
Q. Is Jim Falls one of the plants we have been talking about already, or is that a separate plant?
A. They are one of the four cheese plants that we were talking about.
Q. Okay. So there's a dryer at the Jim Falls plant?
A. There's a couple dryers there, yes.
Q. Do you know if the cost of making high-heat nonfat dry milk is more or less than low heat?
A. I don't know that.
Q. At your four cheddar plants, do you produce any 40-pound blocks?
A. No, we don't.
Q. Do you produce -- I think you answered earlier, you produce 640s only, correct?
A. We produce 640s at three of them and barrels at the fourth one.
Q. So you produce barrels at one of the four plants?
A. Right.
Q. And you produce no 40-pound blocks?
A. Right.
Q. And all four of those plants reported their costs to Dr. Stephenson?
A. Yes, sir, I believe they did. And they are all

3-million-pound-a-day plants, so they are pretty -- they have all had new cheese equipment put in over the last ten years.

Q. Three of the plants, though, were reporting costs but they don't produce the products that are in the Class III survey, right?

A. Run that by me again?

Q. Sure. The Class III formula is based off surveys of 40-pound blocks and 500-pound barrels, correct?

A. Yes. But the 640s are really based off the 40-pound market, also.

Q. Okay. Are the costs to make 640s and 40s identical?

A. I don't know that.

Q. In addition to the Jim Falls plant, how many other of your cheddar plants have drying capacity?

A. The Paynesville plant would have drying capacity.

Q. How do you spell that?

A. Paynesville? P-A-Y-N-E-S-V-I-L-L-E.

Q. See, I'm glad you did that because there's a Painesville, Ohio, that is spelled differently. I would have misspelled that.

A. Okay.

Q. Do those dryers dry the whey from your cheese plant?

A. The Jim Falls plant dries sweet whey; the Paynesville plant dries WPC.

Q. Is that WPC 34 or 80 or both?

A. We can do either or both, right.
Q. Can you produce WPI?
A. We haven't. I don't think we have the -- the technology or the equipment to do that at this point.
Q. It does require specialized equipment to do that, doesn't it?
A. Yes, it does.
Q. Your statement says that Dr. Stephenson collected cost information from 18 cheddar manufacturing plants. Am I right, then, that four of those plants -- four of those 18 are AMPI facilities?
A. I guess I would assume that.
Q. I'm looking now at page 4 of Exhibit 146, and there's a sentence about two-thirds of the way down: "The high-level percent change for AMPI bulk cheese products is 47% higher in 2022 than 2008."
I interpret that as saying that whatever your manufacturing costs were in 2008 for your bulk cheese products, it's 47% higher than that; is that correct?
A. That's what I would assume it would mean.
Q. And when you say "bulk cheese products" that would include your barrels and your 640-pound blocks, correct?
A. I would believe so.
Q. Do you have or does AMPI have the information about just the barrel portion of that?
A. They might. I don't know. I haven't seen it.
Q. Do you know today whether the increase in manufacturing barrels is higher or lower than the cost of

manufacturing 640-pound blocks?

A. I don't know that, but I know a lot of costs are related to labor, and energy, and ingredients, and packaging. And they are probably not exactly the same, but I would think they would be relatively similar.

Q. I think we can all agree costs have gone up since 2007 or 2008, and for better or worse, we have to give these folks the information to figure out what that number is, right?

A. Right.

Q. All right. The next sentence is: "General plant expenses are up 62%."

I'm curious about what you include in "general plant expenses" there.

A. I don't know, but I would assume that it's the same thing included in all of our plant expenses. And I -- from reading that, being our general plant expenses are up 62%, our high-level percent changes 47%, that would tell me that the cheese equipment that we put in there has made us more efficient over time, and that our cost would be much higher had we not done that.

So I guess I don't know if that answers your question, but I -- I just, I guess I don't know exactly what would all be included in that general plant expenses.

Q. I know that in Dr. Stephenson's summary he breaks out a category of general and administrative expenses.

And I was -- I guess my question is, are your general plant expenses, is that the same thing

Dr. Stephenson puts in the bucket of general and administrative?

A. I would almost assume so, but I don't -- I don't know that for sure.

Q. Okay. Your next paragraph talks about some of those improvements that have been made to facilitate fat recovery and how the -- your cost to convert milk still increased immensely.

When you installed new equipment, that -- that, I assume, increases your depreciation and amortization costs. Would you agree with that?

A. It does.

Q. And then so those expenses would -- I think Dr. Stephenson has a bucket that would include those types of expenses?

Would that be where those costs would show up when AMPI figures out its manufacturing costs?

A. The thing is, you wouldn't install those pieces of equipment unless you knew there was a return on investment on those. So, yeah, there might be a different way to allocate some costs.

But if you look at what's happened with the -- with the butter and cheese market over the last number of years, and especially since COVID, we make American-type cheese, which means it's got to be 50% fat or more. And if you're putting $3 butter into $2 cheese, it doesn't work out very good for very long. So you try to put in equipment that removes as much of that fat as you possibly

can, and still be legal, and still make the best product for your customers with that cheese you are making, and then you sell off the cream or put it to the butter plant -- well, we virtually sell it to the butter plant -- to make butter out of it, because it's higher value when it's butter than if it's made into cheese.
Q. Right. So your -- your butterfat -- you describe your fat recovery has improved since 2007, 2008?
A. Well, we invested money in equipment to do that.
Q. Yeah.
A. And our cheese vats that we put in, the yields have improved and the returns have improved on all of those, because you just get more cheese out of every hundred pounds of milk.
Q. Are you using horizontal vats?
A. These are horizontal vats, yes.
Q. And were those installed after 2007?
A. I believe all of them have been.
Q. Do you also use additives like, you know, special coagulants or improved coagulants to improve your butterfat recovery?
A. You know, I don't know that part of it, the process.
Q. Do you know what AMPI's butterfat recovery is?
A. When making it into cheese you mean?
Q. Yes.
A. I don't know that number.
Q. But your investments have improved the amount of

butterfat you are able to recover, correct?
A. Absolutely, yeah.
Q. And those additional costs would be part of making the cheese, right? That would flow through to the Make Allowance, or at least you hope it should?
A. Yeah.
Q. Now, AMPI, as we said, is a member of National Milk, correct?
A. That's correct.
Q. Does AMPI support National Milk's Proposal 1, the one on the base Class I price and the component levels used to calculate it?
A. We -- we generally supported the whole package that National Milk put into the Federal Order hearing process here. Not that we're 100% on board on everything. I mean, if we all were, we probably wouldn't need a hearing, we could probably just ask to make the changes.
So I don't know if I want to get into too much detail on all that. I know, you know, things have changed over time with solids in milk and the value and things like that. But I mean, to me, this whole process is all about getting the right numbers and working together to come up with a program that's going to be something that dairy farmers will support at the end of the day.
Q. I think there's general agreement on -- on -- on that goal. And I don't want to -- because -- because of your answer there, I don't want to get into the real specifics of Proposal 1, but that is one that would have a

delayed implementation?

And your statement makes it pretty clear that when it comes to Make Allowances, you think there should be no delay in implementation, correct?

A. Well, we have been asking for Make Allowance changes for almost a decade. And just because it's taken this long, I don't know why we should wait another decade to get back to where we should have been a couple years ago. You know, I mean, we have been living this world. We have been having real costs. We couldn't tell our vendors, well, we can't afford to pay you so much, or tell our workers, you know, we are going to have to give you less per hour because we just can't make ends meet if we pay full price on everything. We have to pay full price on everything, where the Class III formula doesn't have that figured in.

And those folks -- I'm sorry, but as a dairy farmer that has been living this -- those folks that benefitted the most over the last 15 years from the Make Allowance being outdated are the ones that are going to feel it the most as the -- as this whole thing gets changed.

Q. I think one of the issues that, at least for me, is both interesting and hard to figure out, is which changes to the formulas should be delayed in implementation and which ones should not.

And so, I'd like, if you could, if you have anything else to add, explain why Make Allowances should be implemented -- why changes to Make Allowances should happen now as opposed to a year down the road.

A. Well, if I think about our producers, there are many chomping at the bit to be able to expand, to be able to become more up to date and more competitive in producing milk. And we can't let them do it right now because we don't have the capacity to take that extra milk. In fact, we're limiting them to something that they produced -- a level that they had a couple years ago.

So it's really hard to be a dairy co-op that you want to be there for your members, you want to give them the ability to grow, but because of the situation we're in, we can't let them do that. We can't afford to build a new plant. It would -- it's out of the question.

We have expanded every one of our plants as best we could with the footprint we had. But, I mean, there's only so much you can do. And eventually, we need those real -- real costs figured in so that we are on a level playing field as far as competing for milk, and we -- we get credit for what we have invested in our plants and, you know, that whole market for our members' milk that we provide and get more value out of their milk by doing that.

Q. Thank you.

One of the reasons that have been suggested as a justification for delaying the implementation of a change would be because it would cause problems for risk management, both potentially for producers, farmers, and for cooperatives that are participating in similar activities.

Has anyone at AMPI suggested to you that changes to the Federal Orders would -- would be detrimental to AMPI as an organization, from a risk management standpoint?

A. Well, we have talked about this for a number of years, is that there is real no good way to lock in a milk price right now because the Class III price does not reflect what we're able to pay for milk most of the time because it's overstated.

So you are really -- you are really locking in something based on what you think the difference between now is and the time, you know, when that thing would come through. So it's really not about locking in a price for your milk, and it's really not a -- there's no real good tools for risk management right now because the prices are so distorted.

Q. So would risk management actually become easier once these changes are implemented, if these changes are implemented?

A. I would think it would become more meaningful, so that if you locked in a certain price, you actually feel like that's the price you might end up getting.

Q. And I know you have been testifying on behalf of AMPI, and I asked you that right out of the gate. But for you as a producer, milking cows, do you have concerns about any of the proposals here making it harder for you to manage your risk as a dairy farmer?

A. I guess I don't see any of these proposals making it harder to manage risk.

MR. MILTNER: Thank you very much. I really do appreciate how forthright you have been with answering the questions.

THE COURT: Further questions for this witness -- I'm sorry, time-out, yes. We have been going for -- it's a little more than an hour and a half.

Let's take a ten-minute break. Come back at 11:25.

(Whereupon, a break was taken.)

THE COURT: Back on the record. We're going to break -- I'm sorry, did you have something? Okay.

Off the record we had a discussion, we're going to put a witness on that has an earlier flight. We're going to break the examination of this witness so that we can allow another witness to come in, and then we'll come back to this witness.

MS. LOMBARD: Good morning, your Honor. I'm Jill Lombard. I'm here representing Dairy Farmers of America, or DFA, and I'd like to enter my appearance for the record. My last name is L-O-M-B-A-R-D.

Today I'm introducing three DFA farmer-owners who are here to testify.

So, your Honor, I'd ask that Mr. Palla's witness statement be marked for identification.

Do you have a copy of that?

THE COURT: Did you enter your business address? That seems to be required.

MS. LOMBARD: It's 1405 North 98th Street, Kansas City, Kansas, 66111.

THE COURT: Yes, I seem to have a set. It's Exhibit DFA-2?

MS. LOMBARD: Yes, Exhibit DFA-2, which I think would be number Exhibit 148.

THE COURT: We'll go ahead with that, then. Let's label for identification as Exhibit 148, Exhibit DFA-2.

(Thereafter, Exhibit Number 148 was marked for identification.)

THE COURT: Let me swear in the witness.

Raise your right hand, please.

ERIC PALLA,

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

THE COURT: Thank you.

With that, we have marked the statement. You can ask him about that, and -- welcome.

MS. LOMBARD: Thank you.

THE COURT: Your witness.

MS. LOMBARD: Thank you.

DIRECT EXAMINATION

BY MS. LOMBARD:

Q. Mr. Palla, can you please state and spell your name for the record?

A. Eric Palla, E-R-I-C, P-A-L-L-A.

Q. Thank you.

Can you please state your business mailing address for the record?

A. 1405 North 98th Street, Kansas City, Kansas, 66111.

Q. Thank you.

Mr. Palla, I understand that you have prepared a written statement for your testimony today. Would you please read that statement at this time?

A. Yes.

Hello, my name is Eric Palla, and I am a dairy farmer from Clovis, New Mexico, where our family farms 15,000 acres and milks 10,000 cows. I'm a second generation dairy farmer and have been in the dairy business for over 25 years. I'm a farmer-owner of Dairy Farmers of America and currently have the opportunity to serve on the following boards: DFA Southwest Area Council, DFA's Board of Directors, and the Greater Southwest Agency. Outside of dairy, I also reside on another cooperative board and a couple of educational Advisory Councils. I am here today representing Dairy Farmers of America in support of the proposals submitted by National Milk Producers Federation.

This has been an extremely challenging year for our dairy farm. Since December of 2022, the All-Milk Price has declined by more than $7 per hundredweight, which is far less than the over $10 per hundredweight decrease in my net pay price over the last 12 months.

The challenge in this are costs of production have not gone down. Our dairy is experiencing the worst margins in our history. We have faced significant inflation in our input costs since 2020. For instance, our feed costs are $5 per hundredweight higher, maintenance and repairs are up over 13%, and our fuel and interest costs have doubled.

Nevertheless, we are very proud of the efficiencies we have achieved over the same time period in order to limit cost -- our cost of increases in other items such as labor, vet, utilities, and miscellaneous costs. As dairy farmers, we always do. We come up with better, more efficient ways to operate, to help overcome some of our cost increases. However, even with our improvements and efficiencies in cost cutting, it doesn't go far enough given the current return in the marketplace.

All things equal, even a small increase in Make Allowances will be detrimental to milk prices. I understand that Make Allowances are an aspect in determining Federal Order class prices and from time to time there's a regulatory need to adjust them. However, I ask that in doing so, the Secretary of Agriculture take into account the impact on dairy farm milk prices and, more importantly, the impact on dairy farm profitability.

Our farms have been asked to come -- to become more efficient over time and to absorb the recent input cost increases, while at the same time, we are experiencing much lower milk prices.

We, as farmers, do not have a mechanism to pass along these cost increases to ensure our profitability. As a farmer-owner of a milk marketing cooperative, the financial performance of the cooperative's manufacturing assets also impact my milk check. However, the change in Make Allowance will have an even greater impact on our milk price as it comes out of 100% of our milk marketed.

Within these challenging market conditions, a $0.50 per hundredweight decrease in Class III would move me into a negative operating income. The significant changes proposed by the International Dairy Foods Association and the Wisconsin Cheese Manufacturers Association would create an unsustainable decrease in milk pricing and should be rejected.

In fact, if the proposed change were in place over the last ten years, we would have experienced negative operating income. Over the years, dairy producers have had to deal with all of the same pressures of market competition and incremental cost increases, making profitability very difficult.

Dairy farmers are price takers, while processors are price negotiators. Cheese manufacturers can pass on their higher costs when they sell their products. I do not have that same ability. Milk buyers at manufacturing plants have additional means to cover their operating costs, including lowering over-order premiums.

I strongly object to allowing manufacturers to take additional money out of my milk check when they continue to have other means to cover their production costs. I believe they have the ability and the duty to the dairy producers to exhaust all other avenues to become more efficient in their operations as opposed to paying me less for my milk.

I understand that for a vibrant dairy industry, both producers and processors need to be equipped with the right tools to reach financial success. I support the National Milk Producers Federation package in totality, because it works to modernize the Federal Milk Marketing Order system beyond the Make Allowance increase, but aims to balance added benefits for processors and producers.

However, as a farmer, this package is a compromise, and I would not be supportive of a sole Make Allowance change, especially an increase to the levels others are proposing.

Additionally, I understand that the proposal to change the skim milk component factors is based on dairy farmer component test increases. In 2022, my milk tests averaged 3.76% fat, 3.23% protein, and 9.09% solids nonfat. This has risen from 3.54% fat, 3.11% protein, and 8.9% solids nonfat since 2017.

In my opinion, our milk components have risen over the last several years for a couple of reasons. One is the increasing speed of genetic improvement due to the adoption of new technologies by the dairy industry and the supporting businesses.

I also believe that our ability to feed the cows with more precision, along with advancements in nutritional science, have enabled us to target components more effectively without sacrificing production per cow.

A third reason for component increases is the use of crossbreeding in herds across the United States.

It is my belief that improved management, along with scientific advancement, will continue to increase our ability to produce higher component milk in the future.

The timing of the changes to Federal Order milk price formulas could impact the outcome of the milk price risk management transactions I have used to hedge my dairy's future profitability.

Risk management is an extremely important part of our business. We use several different tactics to try to minimize large price fluctuations and its effect on our bottom line. We use a combination of fixed pricing in both classes of milk, along with Dairy Revenue Protection, and at times, target blend pricing that is offered through DFA risk management.

We tend to protect profitable pricing as far ahead as I can have feed contracted. This can range from three months to up to 18 months ahead depending on the futures price and my desire for risk. We are currently looking at forward pricing and/or adding DRP well into 2024.

It is important to the success of my business that the Federal Orders do not change the milk price formulas for transactions I may have entered into prior to my knowledge of the change in the timing of its implementation.

Ideally, I would like an 18-month delay. This is necessary to protect my transactions from additional risk that was not in the marketplace at the time I made the transaction.

That said, I recognize the broader needs of the dairy industry and support an earlier implementation of the other NMPF proposals, apart from the changes in skim milk component factor which should be delayed 12 months or more.

I close by repeating my support for the National Milk Producers Federation proposal package in totality, but wish to, again, highlight the dire situation dairy farmers are facing within the current marketplace. We operate on very slim margins, even in a good year. As a second-generation dairy farmer, I have had the opportunity to step into the shoes of those that came before me, and work tirelessly to make improvements for the generation after me. Without dairy farmers, there cannot be a dairy industry.

Dairymen will always try to find a way to do what we love to do, which is milk cows, raise our animals, and provide for our families. However, we can't continue to take all of the risk for everyone else to make a dollar in exchange for pennies. We will continue to innovate, manage, and strive for success. We live in optimism, but we can only survive so much.

Thank you for allowing me to testify today on these issues that are very important to my family and the future success of our dairy business.

Q. Thank you, Mr. Palla.

MS. LOMBARD: Your Honor, at this time I'll tender the witness for cross-examination.

THE COURT: Any questions for this witness?

CROSS-EXAMINATION

BY MR. MILTNER:

Q. Good morning, Mr. Palla.

A. Good morning.

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

I have some familiarity with New Mexico farms, and I wondered if you could offer for -- for everybody here, a little bit about the efficiency improvements that have happened at your farm and with other farms in Clovis and Roswell.

A. So to be sustainable in the business, we have to figure out ways to decrease costs or increase production on the facilities that we have in order to limit our cost per hundredweight, on our farm. So it can be anything from technologies, to products that increase feed efficiencies, to equipment, decreasing labor, and an opportunity -- you know, if there's an opportunity to do that, that those are things that we have done to try and be more efficient.

Q. You really look for efficiencies in every point in the process, from feeding to milking to loading out, don't

you?
A. 100%.
Q. Has your farm implemented any new technologies in terms of milk load-out and efficiencies, in that -- in that part of the operation?
A. The biggest thing is making sure that communication on scheduling for the milk trucks, the trucks come in, they load, they leave. We put in as high a capacity pump as we can to get them loaded quickly and get them to market as soon as possible.
Q. Those pumps also minimize the loss of milk in the transfer from tank to truck?
A. Absolutely.
Q. May I assume that most, or if not all, of your milk goes across the street to Southwest Cheese?
A. I would say most, yes.
Q. You -- you make a statement that "if the proposed change were in place over the last ten years, we would have experienced negative operating income."
A. That's correct.
Q. Unfortunately, my understanding is that over the last ten years, it's been more common than not for farms in your part of the world to have negative operating income. Is that correct?
A. That would be accurate.
Q. And there have been a lot of good dairy farms in your part of the world that have gone out of business in the last three, four years especially, correct?

A. Yes.
Q. So it's not even a matter of what happens if we make these changes, it's also already pretty hard in New Mexico right now, isn't it?
A. Yes.
Q. You make a statement that milk buyers at manufacturing plants have means to cover their -- additional means to cover their operating costs, including lowering over-order premiums.
Right now, in New Mexico, is the agency able to get a Class III over-order premium?
A. I don't know for sure. I think in some instances we are able to achieve some, but not in all.
Q. Premiums are also hard to come by right now in the Southwest, correct?
A. Yes.
Q. This issue of risk management and when we implement changes or when USDA chooses to implement changes is something that's been coming up a lot, and you make reference to that in your statement. I have asked this of other witnesses because I want to get people's opinions on it because I really don't know the answer to this, and I don't know that anyone in here really does.
You say that for Proposal 1, which is the proposal that changes the skim milk component factors, you would like to see that delayed for your risk management, but not for the other changes from National Milk.
And I wondered what your thoughts are as a farm

operator, when a risk manager says, this is okay to delay -- or this is okay to do now, and this we need to delay.
Can you help provide some thought on that?
A. I probably don't know the exact specifics, so I'd probably rather not comment on that and not be accurate.
Q. Okay.
When you use DRP, do you purchase your coverage based on class or on components?
A. I will purchase on what is the best return for the time that I can make the purchase. So if the -- I have done both is the short answer. If the class price looks better than the component price. I'll do class price; if the component price looks better than the class price, I can do it on component.
Q. So it's the -- it is the overall economics of the cost of coverage and the potential return that drives your decision?
A. Correct. Basically if the component pricing nets me higher a Class III price, then I will -- you know, and it more than offsets the premium, then I will do the component pricing.
Q. Have you found that one option or the other, class or components, is better for matching the milk that you produce at your farm?
A. No. No, I have not.
Q. Okay. Thanks?
MR. MILTNER: That's all I have.

THE COURT: Other questions for this witness?
Seeing none, AMS.

CROSS-EXAMINATION

BY MS. TAYLOR:
Q. Good morning.
A. Good morning.
Q. Thank you for coming to testify today.
A. Thank you.
Q. I appreciate your statement. I don't actually have too many questions.
One question we do like to ask of all our producers is if they meet the Small Business definition, which for the government is producers making $3.7 million or less in gross revenue on a farm basis a year.
Would your farm meet that definition?
A. No.
Q. I really just have a question or two that centers around the impact that you as a producer have seen on your milk check due to what everyone terms here is inadequate Make Allowances and as a co-op member how that's impacted you. Could you speak to that at all?
A. Not specifically. But I -- I do know that we ship milk to cheese plants that have been profitable with the current Make Allowances.
Q. Okay.
A. And we are getting paid at a minimum class pricing or class pricing plus. And so I do know that that is happening.

Q. Okay. And so if the Make Allowances increase for those plants that you ship to, you --
A. It's going to come out of my milk check.
Q. Right. I'll ask the good question that was just told to me.
On your risk management side of your operation, you talk about how you do contracts anywhere from three to 18 months out. Just curious, kind of like what's the breakdown of that? Do you -- have the majority of those within six, nine, 12? I mean, where is the sweet spot?
A. You know, there's -- there's really not one. It's -- it is actually rare that you can lock in a profit on the futures board in the dairy industry, but if you can, then we typically will take advantage of that.
However, I won't sell my milk in the future unless I know I have my feed costs locked in at the same time. So depending on what positions I can take on feed through either cash or a futures price will determine how far I will go out.
I have locked milk in up to 15 months ahead a couple of different times. You know, more six months is probably more of the average of how far I'll go forward.
Q. Okay.
A. But we do -- we do a variety of different ways.
Q. Okay. Thank you. That's helpful.
MS. TAYLOR: That's it from AMS. Thank you so much.
THE COURT: Any further questions in the nature of

cross?

Seeing none, redirect?

Redirect.

MS. LOMBARD: Your Honor, given that there are no additional questions, I move that the witness' statement be admitted as the next exhibit into the record. I think we identified that as 148.

THE COURT: Yes.

Any objections?

Hearing none, Exhibit 148 is made a part of the hearing record.

(Thereafter, Exhibit Number 148 was received into evidence.)

MS. LOMBARD: Thank you, Mr. Palla.

THE COURT: Thanks for coming in, Mr. Palla. I appreciate it.

THE WITNESS: Thank you for the accommodations, too.

THE COURT: Okay. I understand that we have another witness we want to get up and off the stand before lunch.

We want to recall the witness, Mr. Schlangen. Welcome back. Okay.

Mr. Rosenbaum, if you can do this as well -- who has questions for this witness?

MR. ROSENBAUM: Your Honor, I think if there's anyone else who wants to ask the witness questions, he's available --

THE COURT: Yes.
MR. ROSENBAUM: -- for cross-examination.
THE COURT: Does anyone else have any questions for this witness?
Does AMS have any questions for this witness -- oh, yes, Ms. Hancock.

CROSS-EXAMINATION

BY MS. HANCOCK:
Q. Good morning, Mr. Schlangen. Again, I just had a couple questions I want to talk about you with your producer hat on and talk about your operational expenses.
Have your operational or input expenses increased? And I'm talking about -- yeah, maybe we ought to start there. Have your operational costs increased?
A. Yeah. Well, that's pretty clear they have gradually increased over the last number of years. But, I mean, the last three years a lot of things have really increased a lot.
Q. Things such as labor?
A. Labor's a big deal if you can even find it. And other supplies, cleaning supplies, things you use on the farm, you know, that -- just a lot -- everything is higher than what it was.
Q. And you have seen a greater increase over the last three years than what you have seen historically; is that right?
A. Yes, I would say so.
Q. And -- and that also would include things such as

your feed costs?
A. Feed costs have -- you know, we grow most of our own feed, and feed costs have been gone up and down over the years. They were actually higher a year ago than what they are now. They have come back some.
But generally speaking, feed costs and milk prices, they go fairly well together, just because -- and there's usually a lag in that, the milk price, so to recover, if feed prices really go high, but -- but the inputs to produce that feed have gone up, whether it's fertilizer, chemicals, fuel, everything. So generally, yeah, costs have gone up.
Q. Okay. And you just mentioned fuel. Your transportation costs have gone up quite a bit, haven't they?
A. Yeah. Well, just about everything has a surcharge on it now of one thing or another. But, yeah, fuel prices have gone up. They too can go up and down, but we're just waiting to see if they will ever go down again because we had -- we had better fuel prices a few years ago.
Q. And -- and just -- if we just look back over the last 23 years, that it's fair to say that transportation costs have continued to increase over that time; is that right?
A. I would -- I would say so.
Q. And is your farm a Grade A farm?
A. Yes, it is.
Q. Does it cost you more today to maintain that

standard versus what it cost you 23 years ago?
A. Well, everything costs more. We put in a robotic milker in 2010, and we actually had to switch out a bunch of the valves. It came in from Canada, and it was okay to use there. But with our regulations here, it wasn't okay, and we had to switch those valves over to make it compliant with -- with here, so -- but, I mean, if you look at a lot of other things that have come into play with the farm program, the EU somatic cell count situation -- you know, and then, again, the cleaning equipment -- cleaning chemicals and different things to keep your operation so it is Grade A, everything has gone up some.
Q. Okay. And you mentioned, you know, installing the robotic milker and the cleaning chemicals and some of the those extra items that are required in order to maintain that status. Any other items that you can think of that go into your operation -- your farming operation to maintain that Grade A status?
A. I'll probably think of some when I'm on my way home, but I can't think of anything right now.
Q. I'll think of some things when I leave as well.
Okay. So where you are located in the Upper Midwest, have you seen any of the Class I plants close in that area?
A. I am in Central Minnesota. I -- we hear, yeah, there are some that have closed over time, but none that are right in my location.

Q. Okay. Have you seen any additional costs that you or your that your fellow members have experienced in trying to serve the Class I market?
A. Well, the fact is the Class I market is actually a really small part of our co-op and our milk usage. And the costs for supplying any market has gone up.
So, yeah, you try to, you know, reduce the cost as much as possible, whether you do that through milk swaps or, you know, supplying milk to plants that is a long ways for someone else and you can -- you can swap with them. It's -- any way you can help reduce costs that -- if you're burning up fuel, that money is gone and nobody gets it, so you work together with other co-ops to --
Q. And that's one of the concerns when you are serving plants that would be located farther away are those additional transportation costs?
A. Well, absolutely. Yeah.
Q. So I just want to be clear in this. I think you touched on this earlier, on some of the proposals from National Milk. But does AMPI support National Milk's Proposal 19 for Class I differential increases?
A. You know, we went over that whole price surface study, and we saw the numbers that came in. And I guess I'm not in a position to say that -- I believe all those numbers are legitimate, but I would assume that if they have those numbers, that they -- they can document and -- and defend those numbers as being legitimate in those areas. But I -- I couldn't say for sure if those are

really numbers that -- I guess we support the concept probably of some of that, but to know that that's actually what they believe they need in those areas, I couldn't say that that's 100% accurate.

Q. Okay. So you don't have any information to suggest the numbers that you saw were inaccurate, right?

A. No, I don't. It's just that when I hear about those numbers, and really most of that includes just hauling costs, and then I hear about the Make Allowance numbers that include all these other costs, I don't think the request for Make Allowance changes are anywhere out of line at all if those numbers are as legit as they say they are.

Q. Okay. And the numbers that you looked at when you were working with National Milk for the Class I differentials, as long as the numbers could be supported with the data that was put into the record, you would support those increases?

A. You know, I would think so. I would think and -- but there, again, you know, if you are going to delay implementation of these other things, do you -- do you kind of do that -- everything gradually or do you do everything together, you know, maybe more quickly? I don't know.

Q. And do you have a position on that?

A. It is really hard because I think we all got to, you know, be careful about our whole industry, and we got to find a way to get to a point where it's fair across the country for farmers. And, you know, we have been living in this, what we -- I believe is unfair to manufacturers for a long, long time. And I know it's going to be hard to wait for very long to get those numbers fixed because that affects what we do as far as investment and expanding our capacity and different things like that to provide a market for our members.

So it is not going to be an easy thing, but I guess that's why we're doing a hearing and why we're trying to get all the best numbers out here so that people can make good decisions based on those numbers.

Q. And if you are just looking at your dairy farming operating income, are those pretty -- are those numbers pretty tight as well?

A. Yeah. We have been pretty much a non-profit this year so far. But, I mean, we go through those times, and last year was a good year. We do have the Dairy Margin Coverage now for every farm in the country on their first 5 million pounds of milk, which is helping us through.

But, yeah, the margins are relatively tight. They have been. Sometimes you do better than others. But so far this year I would say most people are -- are struggling. And there's a lot of farms that are selling out and they have had enough.

Q. Yeah. And then on National Milk's Proposal Number 13, reverting back to the higher-of on the mover, do you support that proposal as well?

A. You know, that's something that I -- we thought was working pretty well before it got changed on -- in the first place. And it's pretty clear, if you look in hindsight, that that's not -- not something you should probably do through legislation. It should be done through a hearing process, because when you do those things, it affects other things. And I think this is an example of what can happen when you legislate something. And, of course, nobody predicted a pandemic to really throw a wrench into it really big. But, yeah, I think that's why you need to go through a hearing process to make those decisions, so that everything kind of works together and -- and you come up with a good outcome that people can live with.

Q. Okay. And now that we are here in this hearing, would you agree or support National Milk's proposal to go back to using the higher-of as the mover for the Class I pricing?

A. It seemed like the higher-of had been working in the past. I know there's -- there's talk about risk management and issues with -- with that also. But, you know, it just seemed like that had been working pretty good.

Q. It hasn't been working that great since it has gone to the average-of; is that fair?

A. Well, it did for the first six months or so. It actually looked like it was a real good thing to do until the pandemic hit.

Q. Uh-huh.

A. So it just changes everything. And so I don't know going forward through -- I don't know what's going to be normal going forward, exactly. But I think higher-of has seemed to work pretty good in the past. And I guess I don't know, unless there's a better idea that, you know, could fix this going forward.
Q. Okay. I really appreciate your time today.
MS. HANCOCK: Thank you.
THE WITNESS: Thank you.
THE COURT: Further questions other than AMS for this witness?
Seeing none, AMS.
CROSS-EXAMINATION
BY MS. TAYLOR:
Q. Good afternoon.
A. Good afternoon.
Q. Thank you for coming to testify today.
A. Yep. You're welcome.
Q. I have got questions to ask you on the producer side -- with your producer hat and some on the plant hat. If there's questions on the AMPI plants, that you can't answer, that's fine. I was just curious if there would perhaps be another witness from AMPI that might be coming later to testify kind of on the plant side of the house.
A. I don't know if we have anyone.
Q. Okay.
A. It depends what the questions are if --
Q. Well, I'll give it a try for you, and we'll see

where we go.
A. Okay.
Q. I think you stated in some of the questions that 85% of AMPI's milk goes to your own plants, and then you sell the rest either to fluid plants or other Class III plants; is that correct?
A. That would be my guesstimate on that, but I think we're in the ballpark there.
Q. Okay. Do you know about how much milk AMPI markets on behalf of its members a year?
A. That would be that balance, whatever that would be.
Q. I meant in totality. What would 100% be if you happen to know that?
A. Oh, total milk?
Q. Uh-huh.
A. About 5.7 billion pounds a year.
Q. And do you know how many employees AMPI has in totality as well?
A. That's a good question too. It's in that 1200 range, I think. But, I mean, we have -- we have also made investments in robotics and -- and, you know, different things that reduce those counts because you -- you just couldn't find people to help. So I don't know exactly but --
Q. Okay. That's a good estimate.
And I heard you say that of your plants producing cheese, you produce barrels and 640s, you do not produce

40-pound blocks; is that right?
A. Correct. Yes.
Q. And of those plants that produce those products, can they do either, or are some of them just dedicated to one?
A. For the most part, like we have a Paynesville plant that's just barrels. Jim Falls, Wisconsin, are just blocks. In Sanborn, Iowa, we're trying to work with some things to possibly make some -- have some more flexibility there. But we -- at this point we produce predominantly blocks out of that plant.
Q. Okay. Thanks.
I want to focus first on your statement that is marked 147, and that's in regards to dropping barrels. So we'll start on that topic.
You say that moving to pricing Class III 100% on blocks would complicate milk pricing for barrel cheese manufacturers. And I just wanted to see if you could expand on that. We've asked questions of witnesses previously in the hearing of what would the impact be to barrel makers, you know, who currently your price -- the Class III price at least has some representation of barrels in it, and under Proposal 3, it would obviously only be blocks. So what would you think the impact would be to you all or to AMPI?
A. Well, I think there would be a lot of uncertainty as far as where that barrel price would be, and it wouldn't be included then in what the real cheese market,

the cheddar cheese market, should be, even though -- because barrels is a pretty significant amount of cheese produced in this country, and there's a possibility that that could increase over time with -- we're looking at more processed cheese going out of the country to other parts of the world, that they all use barrels.

And I just think it's risky to remove barrels completely. I think it would be safer to -- you know, to give them a -- a weighted ratio or whatever with blocks, because they are still a huge part of the cheddar market, and if you want a real honest value of what cheddar cheese is worth, I think it has to include barrels.

Q. Would you say if -- does AMPI already have trouble paying the Class III price because it's --

A. Well, it --

Q. -- it has blocks in it?

A. I would say, in most cases, we would be better off selling milk at a Class III price than we would be running that milk through our plants and making Class III products.

Q. Okay.

A. Because the value, the costs are not correct in that Class III price and -- but on the other hand, you can't do that. You have to make the products that your customers want.

But, yeah, if we had the option to just sell milk, you know, who would own a plant if they could sell off an overstated Class III price?

Q. But that's the service you offer your members is to make sure you have a place to put it?
A. Well, that's --
Q. As a co-op?
A. Well, that's a big deal.
Q. Right.
A. Yeah.
Q. Since you make or AMPI makes 640s, I'll ask you sort of an unrelated question.
We have a proposal that's being heard at the hearing to add 640s to the price survey. Do you know if AMPI would support that?
A. You know, I couldn't say that for sure one way or another. I just know that the 640s we already sell are based off of the 40-pound block market.
Q. Okay.
A. So it is really all related anyway as far as, you know, price discovery. So I don't know if that would change anything in that formula, but it would -- yeah. They are definitely connected to the 40-pound block price.
Q. Okay. Thank you.
We have had testimony earlier that talks about the spread between blocks and barrels, and it's been very volatile. The range has been large since 2017. And I'm wondering if you could speak to how the impact of that volatility -- spread volatility has impacted the co-op.
A. Well, that's -- that's been a big deal. We're lucky in a way that we do have one barrel plant that we

can -- you know, we can produce barrels and deal with that price and the other three are pretty much block plants. The only thing is you can't just switch over if blocks are ahead by $0.20. That's $2 a hundredweight. You can't just say, well, we're going to switch over to all blocks now because your customers need your barrels.

So, I mean, to have flexibility would be helpful, but you also need to have customers -- you know, you have to keep your customers happy with the products that they are looking for.

So there are times when barrels are ahead of blocks. There's times when blocks are ahead of barrels. I think a lot has to do with what has come on over the last five to eight years as far as capacity around the country, and it will continue to do with what's coming on as we go here, on -- are there more blocks coming on now that will offset it the other way.

But to -- to make those two totally unrelated and take the barrels out completely I think would be risky and be a mistake.

Q. Okay. We have had other cheese -- or cooperatives that produce cheese testify that if we removed barrels from the price survey, that there would be a transition period, but it is their belief that eventually barrels would just be priced off of blocks. I was wondering if I could get your thoughts on that sentiment.

A. Is that something they would guarantee?

Q. I don't believe they could guarantee it, but

that's what they testified to.
A. I mean, would they say, okay, we'll do this, and then eventually, barrels will be $0.03 under the block market because that's where they belong?
You know, I think market is going to determine what the market price is for those products. And you have a barrel market, you have a block market at the CME, and they are separate, and I think it's going to depend on supply and demand on both of those products to figure out where those markets are going to land. But in all and all, they both produce cheddar cheese, and they all should be part of pricing -- minimum prices for cheddar cheese.
Q. Okay. So I want to move to your Make Allowance discussion. A question on your cooperative, you talked about how you have eight plants to put your member milk through. And obviously, you offer that -- I mean, that's a service to your members to help balance their supply and make sure there's a place for it to go. Does AMPI balance milk for any nonmembers or other cooperative members when needed?
A. Really we just have capacity for our own members. We really don't have any ability to balance because we have actually -- we have closed balancing plants. We have closed smaller inefficient plants that were there when we needed them to -- you know, when all of a sudden the fluid milk people didn't want milk for bottling, you got to find a place to put that milk. And we're so limited now. It's because we couldn't invest and we couldn't afford to keep

those -- those plants running at lower than full capacity, or if -- even if they were just a smaller plant, running them at full capacity.

Q. Thank you.

On page 2 of your statement, and that's Exhibit 146, when you are talking about the inaccurate Make Allowance, or current manufacturing allowance levels in our formulas, and you said: "Simply put, it has become a system based on bad math."

And I think I know what you mean, but I don't like to assume things. So can you expand on that statement and what you mean by that, "bad math"?

A. Well, basically the products we make supposedly set the market price for, in our case, Class III. If those numbers generated from, you know, this kind of a formula price, don't use the right numbers in the formula, the formula price is not going to be right. And that creates a trading situation with a price that's inaccurate and bad math. I mean, really, a lot of those -- when the Class III price is overstated by a certain amount, it means everything that gets sold off of that Class III price is overstated.

Q. And when you say it's overstated, that's because the manufacturing allowances, in your opinion, are not accurate?

A. Absolutely, yes.

Q. Later on that page you talk about when "underestimating processing costs used to determine

Federal Order milk component values, inaccurate price signals are sent to the marketplace that may lead to a misallocation of capital and resources."
Could you kind of expand what you are thinking there?
A. The thing is -- I mean, as a co-op, you are always looking for ways to add capacity, get better return for your farmers through making higher value products. But if you can't afford to do some of those things and follow through with them, then you got to do some other things. It would be like wire tying something together on a piece of equipment to try to limp along and try to keep things going.
And, you know, we just -- there's a lot of things you can't afford to do that you would really like to do, that would be a good return for your farm, all -- your farmers and their milk. But, yeah, it's -- so you end up, you know, doing whatever you possibly can. And some of those investments will probably pay off in the short-term, but they are not a long-term answer.
So it really puts your handcuffs on you as a cooperative to move in a direction you need to move in order to be there for the next generation of dairy farms or to be there for the dairy farmers that are in business right now that want to grow, so --
Q. And on that investment piece, I think -- I don't know where it is now. Somewhere in your statement you talked about how AMPI has put some investment into your

plants. Do you know when that occurred?
A. We have done a lot of investing in our plants over the last ten years. Every single one of our cheese plants has brand new cheese technology for making to get -- you know, making cheese and getting the best return, the best yields, the best quality cheeses out of there. So we have done a lot of investing as best we can.
But those are really small items compared to a -- if you wanted to build a new plant, for example. I mean, you are talking -- any one of our cheese plants would cost $400 million to build, to build a brand new -- and it's like that's just out of our reach because of -- there's not enough return to -- to ever pay that back.
Q. So if I can put that in -- what I have heard in kind of a simple way, right, it's like a Band-Aid approach?
A. That's kind of what I meant, I think.
Q. Okay. Yeah.
On the next page 3 is where you discuss "market premiums have been replaced with significant reblends across much of the country."
And I wanted to talk about like -- about AMPI. Does AMPI reblend to its producers?
A. You know, I don't know what we all do to try to pay the best we can for the milk that we receive. But we pretty much bring the milk in. We make it into the products. Then we supply our customers. We try to get the best price for those products. And then we try to pay

our farmers as best we can based on those returns. And we have real costs involved with that that are not included in some of your other pricing formulas that we don't have a choice but to deal with.

Q. So on the -- on your producer milk check side, then you would see something less than blend prices in order to help your co-op on the plant side?

A. We generally would see whatever the value of our milk is based on the components that we have in it and what we can get out of those components with the markets we have and the costs that we have.

Q. Does AMPI ever choose to not pool milk in order to try to help recoup some of that money?

A. Well, there's times that we have -- have always depooled their milk in different orders just because it makes sense, it is the best return for your co-op. I guess it's just something that's been going on forever. It has just been really exaggerated -- or really increased and magnified over the last five years here.

Q. The last five years. Okay.

If we were to increase Make Allowances and adopt the IDFA proposal that AMPI supports, how do you think that would be -- or impact your milk check as a producer, not on -- as how AMPI's balance sheet is on the plant side, but you as a producer?

A. You know, that will either give us the option to put more money on the milk check or invest more money in our plant capacity. Because of the competitive nature of it all, that we will have a better chance of competing with folks that are just selling off that Class III market price, and hopefully we would be able to invest more in our supply plants and let our farmers grow, get more return, better return for those farmers and, you know, just have a brighter future for all of them.

Q. Okay. And we have had testimony previously in the hearing about other new plants coming online, particularly next year. And so I wanted to get your thoughts on that. And as I asked an earlier witness today, I'm trying to kind of balance how on one side we hear the discussion that Make Allowances are low, and so that's preventing plant investment, but then at the same time we have testimony testifying that there's new plants coming online soon. So just trying to square those two things, and I didn't know if you had any thoughts on that.

A. And I guess I don't know where the capital is coming for those new plant expansions. But from what we -- what we see in our experience, it isn't coming from the return on those plants. But time will tell, I guess, what their returns will be. You know, plants get more efficient as they get bigger also. But they also have a lot of expense to depreciate over time, and that's got to show up somewhere.

But I think in many cases, there is some outside money that could help to expand, and I would be happy to -- to help anyone that wants to help us expand our plants. If they want to -- want to donate some money, we

would be happy to --
Q. Well, you are being broadcasted, so maybe someone will hear that too.
A. I'm not going to hold my breath, I guess.
Q. You also talk about how a lot of cooperatives have installed production limits. Has AMPI had to that for its members?
A. We actually just did this year, yes.
Q. Okay. So they have a base?
A. It's a base/excess plan. So, yeah.
Q. Okay. And is that a result of lack of plant capacity, since you talk about you only have about eighty -- plant capacity for about 85% of your milk?
A. Yeah. And that's, you know, as productions come up some, we might have more production actually than -- than plant capacity by -- it might be even more than that extra 15%. But there's a number of factors in that.
But, yeah, until we have the ability to invest money and grow our plant capacity, right now, we really have to wait for farmers to sell out to -- to allow others to grow, because we are limited on plant capacity. So -- you know, for decades it was best to have an extra 15% of your milk to sell off to people that needed extra milk for this or that or the other thing. We have gotten to a point this last year where any extra milk was going to cost you dearly. And we have even seen competitors that are not co-ops actually just draw a circle and cut farmers off and say, find a new market, and they would actually

then go ahead and buy the surplus milk at a discount and do very well with that.

So it's not been a pretty -- pretty sight, especially this last half a year or a little better.

Q. Can you talk a little bit about AMPI members and -- and I guess the impact of these small margins they have had? Have you seen a lot of AMPI members having to go out of business, just they couldn't last any longer?

A. Well, there's -- there's some that they can't last any longer. There's some that just don't want to put up with it anymore. They are probably at an age where they are not going to invest more to stay in the business. And they have known that over the years it's been really tight margins. Thank God we have a really good safety net for our first 5 million pounds of milk per farm. That's actually kept a ton of farmers in business this year, probably including myself, that we need there -- to be there for the future.

But, yeah, it's been -- it's been challenging. And there's no doubt about that.

Q. At the bottom of page 3, and this is where you are talking about Dr. Stephenson's study and how AMPI participated in that. And you wrote that "these plants" -- and you are talking about the 18 cheddar plants in the Stephenson study -- "produced an average of 122 million pounds of cheddar cheese annually, well above the average cheddar production per plant in this country."

And I just want to make sure I'm clear on what you mean there, is that that's -- you would say that that is weighted more towards a larger plant than the smaller side of plants?

A. Well, to me, 122 million pounds of cheese would equate to about 1.2 billion pounds of milk per year. And our plants are in that 950 to a billion pounds of milk that they will take in a year's time if they are a 3-million-pound-a-day plant, so -- it's really -- really close to what we average, that those -- those numbers come back at averaging.

Q. Okay. So your plants are a little bit smaller than the average --

A. Probably.

Q. -- in that study?

You talked about how AMPI's costs have gone up and the results of this Stephenson survey. Have you looked at -- or has AMPI looked at the Stephenson results and your own plant costs to see kind of how they line up on the cost side? I know we just talked about it on the capacity side of what was represented in the survey. But have you compared the cost side of the equation?

A. Between our plants?

Q. Between what you actually experience in, say, the average of what -- what Dr. Stephenson put out in his latest survey?

Are those -- I guess what I'm asking is, are those numbers representative of your cost or you have higher costs than kind of what his numbers show? Just trying

to --
A. I think those numbers show that we're really close to average of what's -- what's considered an average cost to make cheddar cheese around the country and in those size plants.
Q. Okay. You have a statement in here, and I'll read it: "The high level percent change for AMPI bulk cheese products is 47% higher in 2022 than 2028" -- "2008," excuse me?
I'm just -- I'm not clear on what you mean by the "high level percent change."
A. To me, that would be really the overall increase in expenses over that time. We don't want to, you know, divulge too much information, but I think that's a pretty good estimate of what our costs have gone up.
Q. Okay. So your costs, on average, have gone up -- AMPI's is costs -- about 47% over the 2008 cost?
A. Yeah. And that would be costs on a per pound basis, I believe, and not overall costs because we're going to have the efficiencies that we gain also with putting in new equipment, so --
Q. And the next sentence reads: "General plant expenses are up 62%."
Is that just a subset, is what you pulled out there or --
A. Well, to me, that would mean that we gained some efficiencies, otherwise we would be at 62% increase on overall costs. We were only 47% increase on overall costs

per pound because of the efficiencies we gained -- I mean, overall costs to the plant are up 62%, but that's probably, you know, spread out over more -- more pounds of product produced.

Q. More than just the bulk cheddar?

A. Yeah.

Q. Okay. That's clear now. Thank you.

I know you have talked about your cost increases, and we have all experienced the kind of large increase in inflation over the past year or two. Do you think those cost increases have accelerated in the last year or two, kind of all that inflation and maybe before that period they weren't quite as high? Trying to see what percentage of that cost we can attribute to just the last two years inflation.

A. You know, it would be hard to really quantify that, but I -- I think we have seen costs gradually increase up until when the pandemic hit, and at that point we saw supply chain issues, we saw issues getting packaging and ingredients and a lot of things, and labor's been increased dramatically since then. So it's really accelerated the last couple years, for sure, two to three years, on almost everything.

Q. Okay. Other co-ops' witnesses have talked about how any sudden increase in producer checks -- so larger than what National Milk is proposing, so the IDFA proposal, for example -- would be destructive and result in farms closing. And it doesn't seem like AMPI has that same conclusion.

I'm just wondering if you can talk about that about, why you -- you might not find it as disruptive if -- since you are supporting the IDFA proposal.

A. Yeah. And I think I understand your question, and I think it's probably because, you know, 80 to 90% of our milk goes through our cheese plants, and we get what we get for that already. So we're really only affected if the Class III would get changed or Make Allowance would get changed. It would only be affecting the other percentage of the milk that was sold off that -- those markets. So we are already living those costs. They are out of our milk check already. Where folks that are depending on the Class III sales, they are not out of those sales.

Q. Okay. I understand. You are either living it -- you are living it -- as a producer you are living it through either deducts in your milk check or -- somehow that money comes out of the co-op, either whether it is -- somehow that money is out of your producer check as it is now?

A. Yeah. And it's a challenge to balance that because, of course, producers want to get paid more, but you also don't want to lose your co-op and your market for your milk. So you got to make sure you keep that co-op healthy and -- so that is there for the future. But at the same time, you've got to be as competitive as you can be.

Q. I'm sorry. I'm not distracted, I just get questions from like lots of other people sending me questions. So I'm trying to keep track of everything organized. Make sure I don't miss anything.

Let's see.

MS. TAYLOR: I think Mr. Wilson has a question.

CROSS-EXAMINATION

BY MR. WILSON:

Q. Good afternoon.

A. Good afternoon, Todd.

Q. On the top sentence on page 5 of the Exhibit 146, you talk about the prices paid by unregulated competitors.

I was just trying to figure out, is this unregulated -- FMMO unregulated? Is it unregulated markets? What kind of unregulated competitors are you thinking about in this sentence?

A. I would assume that's competitors that are not in the Federal Order system.

CROSS-EXAMINATION

BY MS. TAYLOR:

Q. We have a team of people and they remind me of the questions I forget to ask.

I did want to ask you as a producer, if your farm would meet the Small Business definition, which is farms producing -- or earning $3.75 million or less in gross revenue a year.

A. Easily. Yes.

Q. And could you speak to what kind of the farm sizes

of other AMPI producers? I think you said you had 60 cows. What's the range of --
A. We have farms of 12 cows up to 10,000 cows.
Q. Okay.
A. And everything in between.
Q. Everything in between.
MS. TAYLOR: I think that's it. Thank you so much.
THE WITNESS: Thank you.
THE COURT: Mr. Rosenbaum.

REDIRECT EXAMINATION

BY MR. ROSENBAUM:
Q. Steve Rosenbaum.
Is AMPI 100% Grade A?
A. I believe we are. Yeah, there was a time we had some Grade B, but we -- we went to 100% Grade A.
Q. And I think I neglected to -- at the early stage -- to ask you for your work address, which we're supposed to have for all of our witness.
A. Yeah, there we would use the AMPI home office address, which would be New Ulm, Minnesota.
Q. Is there a street address associated with that?
A. It's Broadway Avenue. I don't know what exactly the number would be, but you can't miss it.
MR. ROSENBAUM: Well, I love to end things with a humorous question and answer, and at this point I would simply move 146 and 147 into evidence.
THE COURT: Any objections?

Hearing none, Exhibits 146 and 147 are made a part of the hearing record.

(Thereafter, Exhibit Numbers 146 and 147 were received into evidence.)

THE COURT: Yes, ma'am.

MS. LOMBARD: Yeah, your Honor. We would like to ask you and the other parties to consider taking a shorter lunch. I know that we're pretty far into the day. We have two farmers who still need to testify, and they are trying to make it back to the farm. So I don't know if a 30-minute lunch or shorter lunch option is --

MS. TAYLOR: I think the issue is we have got to balance our court reporter, give her a break.

MS. LOMBARD: Oh, yes.

MS. TAYLOR: We are running her already pretty hard for a lot of days, so --

MS. LOMBARD: I defer to you guys.

MS. TAYLOR: I think that's going to be an issue. I don't know what the time constraints are. I don't know the specific time constraints that you are talking about.

THE COURT: I think we have said in the notice -- not we, not me, but you all -- we said something about a one-hour lunch, too. So I -- I understand we'll do the best we can to accommodate the dairy farmers, they are important to us, but I think with we probably need a -- I'm sorry.

MS. LOMBARD: We have two left, so -- and I was going to originally propose that one go before we break for lunch, but I know that we're -- again, it's -- it's up to you guys. My understanding is that Paul needs to get back as soon as he can.

No, he's not flying, so he's not catching a flight.

THE COURT: Let's go off the record.

(Off-the-record.)

THE COURT: We'll come back on the record. Break for lunch until 1:40.

(Whereupon, the lunch break was taken.)

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THURSDAY, SEPTEMBER 7, 2023 - - AFTERNOON SESSION

MS. LOMBARD: Jill Lombard representing Dairy Farmers of America, introducing a second DFA farmer-owner, who is here to testify today.

Your Honor, I would ask that his witness statement be marked for identification, that's Exhibit DFA-1. I think that will be 149.

THE COURT: Yes. So marked.

(Thereafter, Exhibit Number 149 was marked for identification.)

THE COURT: Please raise your right hand.

MS. LOMBARD: Thank you.

PAUL WINDEMULLER,

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

THE COURT: Your witness.

MS. LOMBARD: Thank you.

DIRECT EXAMINATION

BY MS. LOMBARD:

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

A. Paul Windemuller, P-A-U-L, W-I-N-D-E-M-U-L-L-E-R.

Q. Thank you.

Please state your business mailing address for the record?

A. 1405 North 98th Street, Kansas City, Kansas, 66111.

Q. Thank you.

I understand that you have prepared a written statement for your testimony today. Would you please read that statement at this time?

A. Yes, I will.

My name is Paul Windemuller, and I appear before you today as a first-generation farmer and the sole owner of Dream Winds Dairy, LLC, located in Coopersville, Michigan. Together with my wife, we started our farm a decade ago with a modest herd of 30 cows, which has since grown to 260 cows in a state-of-the-art, robotic milking facility.

My journey into the agricultural world began at my parents' farm equipment dealership, where I was immersed in the foundational principles of farming. This invaluable experience nurtured my passion for agriculture and laid the groundwork for an understanding of and a commitment to the industry.

Today, my family lives on our farm where my wife and I homeschool our six children, providing them with a nurturing environment that fosters both academic growth and a deep connection to agriculture and the community.

I am not only a dedicated farmer but also a farmer-owner of Dairy Farmers of America (DFA), and my commitment to the cooperative has led me to serve in various leadership positions, from area delegate to Mideast Area Council Board Member.

Moreover, I hold a Series 3 commodity broker license, which I acquired to better serve my clients with risk management strategies in my niche farm consulting business. I also have experience in dairy construction projects across the country, including general contracting, which has enriched my knowledge of the industry.

Beyond the U.S., I have explored the global dairy industry attending conferences and industry events in countries like New Zealand, Vietnam, Singapore, France, and the Netherlands. These international experiences have broadened my perspective and inspired innovative approaches to our dairy practices.

Dream Winds Dairy, LLC, is not just an enterprise; we strike to make it a pillar of our local community. We take great pride in contributing to the financial prosperity of 40 local businesses and neighboring farms on a monthly basis. We stay involved by hosting community events, 4-H meetings, and school tours, as well as volunteering over 400 hours annually.

Now, I am here today to lend my support to the five proposals put forth by the National Milk Producers Federation (NMPF). These proposals address critical issues impacting the dairy industry, and I believe they merit serious consideration.

They are:

(1) Limit the Make Allowance increase to NMPF's proposed levels;

(2) return to the higher-of in the calculation of Class I mover;

(3) Eliminate 500-pound barrel cheese pricing from the calculation of the Class III protein price;

(4) Increase and regularly update skim component tests used to determine the Federal Milk Marketing Order skim milk price;

(5) Adopt NMPF's Class I price differential proposal.

Over the past year, our farm has faced considerable challenges as have many dairy farms in our community. Despite rising production costs, the pay price reflected in my milk check has plummeted by $8.62 per hundredweight over the last 12 months, placing significant financial strain on our farm. Our input costs, particularly feed and labor, have surged dramatically since 2020. Further squeezing our farm's profitability. Additionally, milk hauling rates have increased by an astonishing 300% over the last nine years, increasing from $0.45 per hundredweight to $1.38 per hundredweight, creating an undue burden solely on farmers like us.

While I understand the necessity of adjusting Make Allowances from time to time, I urge the USDA to carefully consider the impact on dairy farm milk prices and the overall profitability of dairy farms when implementing such changes.

The more modest adjustments to Make Allowance -- to Make Allowances proposed by NMPF, which amount to about $0.50 per hundredweight reduction in producer pay prices, are reasonable and preferable to the much larger increases suggested by International Dairy Foods Association and the Wisconsin Cheese Manufacturers Association.

The larger Make Allowances -- excuse me -- the larger Make Allowance increases would jeopardize the viability of our family farm.

Regarding the proposal to modify skim milk component factors, I can confirm the proven and documented tests showing notable increases in milk components. Year to date, 2023, our farm averaged 3.9% butterfat, 3.2% protein, and 5.76% other solids.

In 2018, our component averages were 3.6% butterfat, 3.02% protein, and 5.72% other solids. We are proud to have achieved these increases through better management, better feeding practices, superior cow genetics, and improved cow comfort.

Our focus on producing milk with higher components aligns with market demands and has been an integral part of maintaining a profitable operation. Updating the component factors of the skim milk formula just makes sense through this Federal Order hearing process, given the on-farm progress toward higher milk components on our farm and across the country.

I would like to impress upon you the need for an adequate notification period prior to implementing any revisions to Federal Milk Marketing Order milk pricing formulas.

Over the last several years, we have delved further and further into developing a workable sustainable risk management strategy for our farm. We are diversified and use several different tools for managing milk price risk.

The federal government's Dairy Margin Coverage is an important mainstay with our risk management strategy, but it is not the only tool that we use. We also use Dairy Revenue Protection (DRP) and forward contract prices up to 16 months in advance. We have used both Class III and Class IV forward contracts to try to stabilize our milk price.

In conclusion, I wholeheartedly endorse NMPF's five proposals. These proposals are crucial for the future success of our dairy business and the livelihoods of countless farmers across the nation.

Thank you for allowing me to share my testimony today, and I trust that USDA will carefully consider the concerns and recommendations expressed here. Your support in adopting and implementing these measures will undoubtedly strengthen the resilience of the American dairy industry. Thank you.

Q. Thank you, Mr. Windemuller.

MS. LOMBARD: Your Honor, at this time I'll tender the witness for cross-examination.

THE COURT: Very well. Any questions?

CROSS-EXAMINATION

BY DR. CRYAN:

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

Hello, Mr. Windemuller.
A. Good afternoon.
Q. It's nice to meet you today.
You've talked about some of the things you do for the community, including farm tours, and I understand you also do some farm tours to help folks from other parts of the State understand -- Farm Bureau tours to help folks from other districts to understand how you operate.
And you are active in Farm Bureau; is that right? You're a member and active?
A. Yes, that's correct.
Q. Thank you. Thank you for your participation.
I know that there have been some issues in -- in the Mideast order with negative PPDs and depooling, especially in 2020 and 2021.
Can you talk about some of the impacts that had on you and your -- your neighbors?
A. So during 2020, I was very fortunate for our farm to have forward contracted through DFA the PPD, and that was a very big help. We had PPDs that were in the range of negative $7-plus for a few months. And I didn't feel the effects of that because of that forward contract that we had as much, which was, like I said, a big blessing. But many neighbors in our area had been negatively affected by that. And there is a lot of confusion I think, among producers of why that took place and how that happened.
Q. Thank you.

DR. CRYAN: Thank you very much. Have a safe drive home.

THE WITNESS: Thank you.

THE COURT: Mr. Miltner.

CROSS-EXAMINATION

BY MR. MILTNER:

Q. Good afternoon, Mr. Windemuller.

A. Good afternoon.

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

The milk from your farm in Coopersville, do you know where it goes on a regular basis?

A. Currently it goes to the cheese plant in St. Johns, Michigan.

Q. Okay. Midwest Cheese?

A. Correct.

Q. The only other question I had was about your statement at the bottom of page 2 where you said you would like to impress upon us the "need for adequate notification period prior to implementing any revisions to Federal Milk Marketing Order milk pricing formulas."

Would you be -- are you looking for a delay in implementation for any change or any proposal or specific proposals?

A. I put that in there, like I said, and -- I believe it was the paragraph following -- sorry, I can't find it right now -- where I specified that I have had contracts up to 16 months prior to that current time.

Looking at -- as I forward contract and look out to do risk management, if there are going to be any mechanisms that could affect contracts that I already have in place, that was my reasoning for making sure that that was taken notice of, that it wouldn't negatively affect contracts that were already currently in place.

Q. So is it -- am I -- would I be correct to say that if the contracts that you do already have in place would be honored according to their current terms, you would not see a need to delay implementation of any proposal?

A. I guess I don't have adequate information to decide whether there's any adverse effects to it at this time.

Q. Okay.

MR. MILTNER: Thank you very much.

THE WITNESS: Thank you.

THE COURT: Further questions other than AMS?

AMS.

CROSS-EXAMINATION

BY MS. TAYLOR:

Q. Good afternoon.

A. Good afternoon.

Q. Thank you very much for being flexible today. We appreciate that.

Just a couple of questions, I don't know if you had heard earlier in the day, I asked some other farmers if they met the Small Business definition of $3.75 million or less in gross revenue a year.

Would your farm meed that definition?
A. Yes, that would be correct.
Q. I also had asked a question of other farmers. Just if you could, you know -- in this discussion, we're here to talk about Make Allowances this week. And I was just wondering if you could speak to how your farm has been impacted by, you know, the current manufacturing allowance levels that I think most parties in this room would agree that they are -- or would argue that they are not high enough as to the level they should be. That's under discussion.
But just if you had any thoughts on how that has impacted you as a producer and a co-op member specifically?
A. I would say I don't have adequate information on the manufacturing side of the equation. I do know that there have been several very large new plants built in the Mideast area in the last decade. So to me, that signals that there is an opportunity there for processors.
But I do know -- I did some math, rough math, off of what the IDFA's proposed increase would mean to my farm. Looking at that increase difference between what NMPF is proposing would actually be -- the difference for my farm on a monthly basis would be double our family living expenses, to give you perspective.
Q. Thank you.
You talked about your risk management use and how you protect anywhere up to 16 months in advance, just kind

of depending on circumstances. I had asked this of other people just kind of -- I mean, that's your range, but kind of, what do you -- a sweet spot you look to protect and do you -- I think our previous dairy farmer witness we had before lunch talked about how you try to forward contract out feed at the same time to protect both sides. So if you could speak to that.

A. Yeah. I actually gave that some thought when you asked the last producer that.

So looking back at my contracts, they would usually range in the six to 12 months depending on what type of contract it was. And then like the former speaker mentioned, I also do try and lock in our feed. I am 100% purchased feed operation, so it is very critical to me to make sure I have that protection on the feed side as well, because I don't have the hedge of growing it myself, so --

Q. Okay. Thank you.

And one just kind of technical question. You talk about on the bottom of page 2 the need for adequate notification. I was just wondering if you wanted to define what that would be or are you supporting for the one piece of National Milk's Proposal the 12-month delay, and that's what you are talking about?

A. Sorry. Could you repeat the last part of your question there?

Q. Sure. I was just -- you talk about the need for adequate notification, but you don't define what adequate would be, like that's kind of subjective. So I was wondering if you would just kind of give a guess on what you think is adequate?

A. Yeah. I would speak for myself, that 12-month mark, and that's where the vast majority of my contracts would be out. Very few times have I locked out -- or locked anything beyond 12 months. I have a few times, but very little. So that 12-month window for me would be something that I would look to, as a -- as a definitive range.

Q. Okay.

MS. TAYLOR: That's it. Thank you so much.

THE WITNESS: Thank you.

THE COURT: Any other questions?

Redirect.

MS. LOMBARD: Thank you, Mr. Windemuller.

Your Honor, if -- given that there are no additional questions, I would move to admit Exhibit 149.

THE COURT: Exhibit 149 is entered into the record of this hearing.

(Thereafter, Exhibit Number 149 was received into evidence.)

THE COURT: Thank you, Mr. Windemuller, you are dismissed.

THE WITNESS: Thank you.

THE COURT: Your right hand, please.

MATT JOHNSON,

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

COURT: Thank you.
Your witness.
MS. LOMBARD: Thank you.
Again, Jill Lombard representing Dairy Farmers of America, and I'm here to introduce our final DFA farmer-owner who is testifying for us today, Mr. Matt Johnson.
Your Honor, I'd ask that Mr. Johnson's witness statement be marked for identification. It's Exhibit DFA-3. It should be Exhibit 150.
THE COURT: Yes. So marked. I think we're up to 150, yes.
(Thereafter, Exhibit Number 150 was marked for identification.)
MS. LOMBARD: Thank you.
DIRECT EXAMINATION
BY MS. LOMBARD:
Q. Mr. Johnson, can you please state your name for the record?
A. My name is Matt Johnson. That's M-A-T-T, J-O-H-N-S-O-N.
Q. Thank you.
Please state your business mailing address for the record?
A. 1405 North 98th Street, Kansas City, Kansas, 66111.
Q. Thank you.
And I understand that you have prepared a written

statement for your testimony today. Would you please read that statement at this time?

A. I will.

My name is Matt Johnson, and I am a first generation dairy farmer from Southwest Georgia. In May 1999, my father, uncle, and I purchased the farm from one of my dad's veterinary clients. The day we took ownership, we were milking 350 cows and farming 250 acres. Today, the farm consists of 28 employees milking 1400 cows, raising 1250 replacement animals, and growing multiple crops on approximately 1,000 acres, primarily for forage for our farm.

I am blessed to serve the dairy farm families of Georgia and Dairy Farmers of America through several leadership positions. Currently, I reside in DFA's Southeast Area and serve on the Southeast Area Council as well as DFA's corporate board. I also serve as President of the Board of Directors for the Dairy Cooperative Marketing Association.

Additionally, I have the honor to serve as the President of the Georgia Milk Producers Association, representing the dairy farm families of Georgia. I am also involved with the U.S. Dairy Export Council's Dairy Trade Envoy, a cohort of farmers and industry staff working together to help educate legislators on the importance of dairy exports.

I appear today in support of the five proposals offered by National Milk Producers Federation:

(1) Limit the Make Allowance increase to National Milk Producers Federation proposed levels;

(2) Return to "the higher-of" in the calculation of the Class I mover;

(3) Eliminate 500-pound barrel cheese pricing from the calculation of the Class III protein price;

(4) Increase and regularly update the skim component test used to determine the Federal Order skim milk price;

(5) Adopt NMPF's Class I price differential proposal.

This has been a challenging year on our farm. Since December of 2022, my pay price, as reflected in my milk check, has decreased by $5.84 per hundredweight. Our costs of production have not gone down to the same degree, and our dairy's profitability has been reduced substantially. We have faced significant input cost inflation since 2021, which are summarized in the table below.

I understand that Make Allowances are an important aspect in determining Federal Order class prices, and from time to time, there is a regulatory need to adjust them.

That being said, I am displeased about the impact on my milk price when Make Allowances are increased. Simply said, my milk price will go down when Make Allowances go up. I ask that when increasing Make Allowances, the Secretary of Agriculture consider the impact on dairy farm milk prices, and more importantly, the impact on dairy farm profitability.

NMPF has proposed a more modest change to Make Allowances, which are projected to lower farm milk prices by about $0.50 per hundredweight. While that level of price decrease is troublesome and concerning, we can live with the change. The much larger increases to Make Allowances as proposed by the IDFA and the Wisconsin Cheese Manufacturers Association would crush my farm's profitability and should be rejected.

Cheese manufacturers have the opportunity to pass on higher manufacturing costs when they sell cheese. Unfortunately, I do not have the ability to pass along the increased cost of production.

Milk buyers at manufacturing plants have other means to recover their operating costs, including reducing over-order premiums and using revenues obtained by depooling from the Federal Order. Because dairy manufacturers have other means of passing along their costs, there is no need to place a large burden on dairy farmers with large Make Allowance increases. A more modest approach to increase -- increasing Make Allowances is appropriate.

I understand that the proposal to change the skim milk components factor is based on proven and documented tests from farm milk that show inarguable increases in milk components.

In 2022, my milk averaged 3.69% butterfat, 3.18% protein, and 5.76% other solids. These have increased by

3.5% percent since 2021. These increases have come from management decisions to crossbreed our herd to capture higher components and revenue in the same volume of milk. Better forage harvest management as well as better feed bunk management have also contributed to our increased components. As technology and information continue to improve, along with more -- along with more of our genetically superior young stock moving into the milking herd, I expect our component levels to continue to improve.

Updating the component factors of the skim milk formula just makes sense to the Federal Order hearing process given the on-farm progress toward higher milk components across the country.

It is important to the success of my risk management strategy that the Federal Order milk pricing formulas are not changed without a lengthy notification period. Ideally, there would be a 12-month delay in implementation after the revised skim milk component factors in the class pricing formula have been adopted.

That said, I recognize the broader needs of the dairy industry and support an earlier implementation for some of the other changes found in NMPF's proposals, for example, increasing Make Allowances, reinstituting the higher-of in the Class I formula, and eliminating 500-pound barrel cheese pricing from the Class III protein price formula.

I close by reiterating my support for NMPF's five proposals:

(1) Limit the Make Allowance increase to their proposed levels;

(2) Return to the "higher-of" in the calculation of the Class I mover;

(3) Eliminate the barrel cheese price from the calculation of the Class III protein price;

(4) Increase and regularly update the skim milk components test used to determine the Federal Order skim milk price;

(5) Adopt NMPF's Class I differential proposal.

Others representing DFA will be speaking more directly on some of these issues. Thank you for allowing me to testify today on these issues that are very important to my family and the future success of our dairy business.

Q. Thank you, Mr. Johnson.

MS. LOMBARD: Your Honor, at this time I'll tender the witness for cross-examination.

THE COURT: Any questions?

Dr. Cryan.

CROSS-EXAMINATION

BY DR. CRYAN:

Q. Roger Cryan for the American Farm Bureau Federation, and I have a completely surprising set of questions.

Mr. Johnson, thank you for coming. It's -- I'm really -- I'm glad to see you.

And you are a Farm Bureau member; is that correct?
A. I am.
Q. And you have been pretty active over the years?
A. I have been.
Q. I appreciate that down there in Georgia, so you are a compatriot of our AFBF president.
A. Know him very well.
Q. Also a former dairy farmer.
A. Yes.
Q. Not that you are a former dairy farmer. He's a former.
And then I'll mention that President Duvall has told me that every day he misses his dairy cows. He's got beef cows, but they are not the same.
And you attended our forum last October, the Farm Bureau forum?
A. I did.
Q. I appreciate that as well.
And I'll say again, I appreciate the support from you and from DFA and from National Milk in participating in that and leading to some good consensus on that. And I'd just like to highlight a couple of those.
If I understand, two of the -- in particular, of the consensus points that came out of that were support for the "higher-of"; is that correct?
A. Yes.
Q. And that ultimately that we should have Make Allowance increases based on mandatory audited

surveys --
A. Correct.
Q. -- data?
And I appreciate that we're all -- we're all aiming ultimately for both of those, among other things, so -- and I'll -- I'll leave it at that.
DR. CRYAN: Thank you very much for coming. Safe travels.
THE WITNESS: Thank you.

CROSS-EXAMINATION

BY MR. MILTNER:
Q. Good afternoon.
A. Good afternoon.
Q. I'm Ryan Miltner. I represent Select Milk Producers. You have probably heard that throughout the day. They like me to say it for the record.
A non-surprising question from me as well.
A. Okay.
Q. Your statement suggests that we -- that USDA include a lengthy notification period when adopting certain changes to the orders, but not for others.
Given your risk management on your farm and your experience in the industry, which is pretty extensive, what do you think is the -- what are the factors that USDA should consider when deciding what should be delayed, and what should be implemented right away?
A. I think if there's going to be any consideration for a delay, on-farm -- on-farm risk management programs

and how these changes could affect those should be considered. Beyond that, I'm okay with -- with any changes being implemented immediately.
Q. Would changes that increase the price to you on the farm affect your existing risk management contracts?
A. At this time, no.
Q. Would changes that lower the on-farm price affect your current risk management programs?
A. At this time, no.
Q. You mention that you're -- you are the president of DCMA, of their board?
A. I am.
Q. Does DCMA set over-order premiums for your order?
A. I wouldn't say DCMA sets over-order premiums. DCMA negotiates with processors to collect over-order premiums.
Q. Do they announce what the premiums are for a given month?
A. They do.
Q. Does DCMA announce an over-order premium for Class III milk?
A. Not that -- no.
Q. How about Class II?
A. Class II we do.
Q. And Class IV?
A. Don't think so. No.
Q. Okay. Do you know if they ever have?
A. I don't know if they ever have.

Q. Okay.
MR. MILTNER: Thanks very much.
THE WITNESS: Thank you.
THE COURT: Further questions other than AMS for this witness?
Seeing none, AMS.

CROSS-EXAMINATION

BY MS. TAYLOR:
Q. Good afternoon.
A. How are you?
Q. I think I had the pleasure of having you on the witness stand a few months ago, so --
A. Yes.
Q. Thank you for your continued participation in our rulemaking efforts this year.
A. Thank you.
Q. For your farm of 1400 cows, would that meet the Small Business definition?
A. No, it does not.
Q. Okay. And Mr. Miltner was asking you about risk management and the impacts on your farm, but I gather from your answers maybe perhaps right now you are not using any risk management tools.
A. I have used all of the risk management tools out there. Currently I'm not using any.
Q. Okay. But you have in the past, and you may in the future?
A. Yes. Yes. And it's always an option. It's --

right now it is just not -- I tend to move in and out of risk management at different times depending on the milk price and the opportunities involved.
Q. Sure. And when you do use risk management tools, about how far out in the future do you look to lock in?
A. I typically don't look at anything closer than six months, and I'm typically not going any further than about 12 months.
Q. Okay. Six to 12 months.
You do -- on the topic of premiums, you talk about how milk buyers at manufacturing plants can have other ways to recover their operating costs, including reducing over-order premiums.
Is that something that you have experienced in the Southeast?
A. Yes.
Q. Reduced premiums?
A. Yes.
Q. And not just on -- well, not on Class III as you answered?
A. So my market is typically -- is 80 -- 60 to 80% Class I.
Q. And I'm curious if you can just expand on the record how you as a producer have been impacted, particularly since your speaking as a cooperative producer. How has your milk check been impacted by what those here are -- are inadequate Make Allowances?
A. So because I'm in a Class I market, any

Make Allowance increases will be negative to my farm. To my knowledge, Class I plants can't draw Make Allowances, so the fact that the Make Allowance is included in the Class III and Class IV pricing, which is then used to determine the Class I mover, most of my milk goes into Florida, which is an 85% Class I utilization, it's all negative.

MS. TAYLOR: I think that's it. Thank you so much.

THE WITNESS: Thank you.

THE COURT: Redirect?

MS. LOMBARD: Thank you, Mr. Johnson, for your testimony.

Your Honor, I move to admit Exhibit 150 into the record.

THE COURT: Exhibit 150 is admitted.

MS. LOMBARD: Thank you.

(Thereafter, Exhibit Number 150 was received into evidence.)

THE COURT: Thank you, Mr. Johnson. Appreciate you coming out.

What's next?

MS. HANCOCK: Your Honor, we would call Jeff Bushey to the stand now.

THE COURT: Raise your right hand.

JEFFREY BUSHEY

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

THE COURT: Your witness.
DIRECT EXAMINATION
BY MS. HANCOCK:
Q. Good afternoon, Mr. Bushey. Would you mind stating and spelling your last name for the record?
A. Jeffrey Bushey. Last name B-U-S-H-E-Y.
Q. And what is your mailing address?
A. My office address is 7274 Hartley Street, Pigeon, Michigan.
Q. And where are you currently employed?
A. At Nietzke & Faupel.
Q. And are you here to testify on behalf of National Milk's proposals today?
A. I'm here to testify on some information that was used, I believe, in some of the other testimonies.
Q. Okay. And you understand that that's on behalf of National Milk Producers Federation?
A. Yes.
Q. And did you prepare the written statement that is identified as Exhibit NMPF-26?
A. Yes.
MS. HANCOCK: And, your Honor, if we could mark for identification his written testimony, as I believe we are at Exhibit 151?
THE COURT: We are. So marked.
(Thereafter, Exhibit Number 151 was marked for identification.)
MS. HANCOCK: Thank you, your Honor.

BY MS. HANCOCK:
Q. And, Mr. Bushey, did you also prepare two exhibits to accompany your written testimony?
A. Yes, I submitted two documents.
Q. And the first one that's identified as Exhibit NMPF-26A, and the title of that is the Happy Cow Dairy, LLC, Financial Statements, dated December 31st, 20XX and -- or I'm sorry -- 20XY and 20XX; is that right?
A. Yes.
MS. HANCOCK: Your Honor, if we could mark that for identification purposes as Exhibit 152.
THE COURT: So marked.
(Thereafter, Exhibit Number 152 was marked for identification.)
BY MS. HANCOCK:
Q. And then finally you have your second attachment, which is titled Nietzke & Faupel, PC, December 31st, 2022 and 2021, dairy averages, and we have identified that as exhibit NMPF-26B as in boy. Is that right?
A. Yes.
MS. HANCOCK: Your Honor, if we could marked for identification purposes, NMPF-26B as Exhibit 153.
THE COURT: So marked.
(Thereafter, Exhibit Number 153 was marked for identification.)
BY MS. HANCOCK:
Q. Mr. Bushey, would you proceed with providing your testimony today, please? And just a reminder, if you can

read slowly for our court reporter, that would be great.

A. Okay.

My name is Jeffrey Bushey, CPA. I'm the Managing Principal of Nietzke & Faupel, PC, a CPA firm that serves a wide range of clients, specializing in tax and accounting for agricultural business, particularly the dairy industry. I have over 30 years of experience in serving the accounting needs of farmers in the Great Lakes region.

I graduated from Central Michigan University with a Bachelor of Science in Business Administration. I began working at Nietzke & Faupel after graduation and earned my CPA license in 1987. In 1992, I became an owner of the firm and now serve as Managing Principal.

I am also a member and past president of the Farm Financial Standards Council, a nationwide organization committed to standardizing the reporting formats of agricultural entitles. I currently serve as the co-chair of the Technical Committee for the FFSC. I am also a member of the Michigan Association of CPAs and the American Institute of CPAs.

As the Managing Principal of Nietzke & Faupel, PC, I lead a team of 14 accountants who provide accounting solutions to our clients. We offer a wide range of services to over 50 large dairies in the Great Lakes region, such as tax preparation and planning, specialized financial reporting, payroll, business valuations, estate planning, and more.

I have been asked by the National Milk Producers Federation to appear today to provide an overview of our dairy farm client operating trend information and answer any questions you may have.

You were provided with a sample dairy financial statement, as well as a copy of the dairy industry averages that our firm has compiled. In this testimony, I will describe how we prepare the financial statements and compile these averages for our dairy clients.

The process begins by receiving the quarterly data from our dairy client. This usually comes in the form of a QuickBooks backup. We perform various procedures to ensure the accuracy and completeness of the data provided, such as ensuring all material bank accounts are reconciled to the bank statements, confirming loan balances with the lenders, and resolving any errors or discrepancies in the transactions. This ensures that the data is accurate and consistent for the preparation of cash basis tax returns for the dairy farm. It also serves as a starting point for preparing financial statements.

We compile the dairy financial statements according to Generally Accepted Accounting Principles, known as GAAP, G-A-A-P, with one exception, which I will explain later. GAAP is a set of rules and standards for accountants to prepare financials in a consistent and comparable manner.

The main differences between a GAAP basis financial statement and the tax-basis data are as follows:

(1) GAAP basis financial statements recognize income and expenses on the accrual basis when incurred;

(2) GAAP basis financial statements recognize inventory on hand;

(3) GAAP basis financial statements depreciate capital assets at a different rate than the farm uses for tax preparation.

There are significant adjustments made when preparing GAAP financial statements from the cash basis of accounting to the accrual basis. The accrual basis of accounting requires adjustments to recognize revenues and expenses in the period in which they are earned and incurred, respectively.

Regarding the timing of the cash flows, for example, a commodity receivable is recorded for milk checks that are earned in the current month but not deposited until the next month. Similarly, accounts payable are recorded as well as any prepaids or accrued expenses to correctly present the expenses in the period incurred.

Another adjustment made when preparing GAAP financial statement is recognizing the feed inventory. For tax purposes, feed inventory is expensed when paid. For financial statements, forages are capitalized to assets at the cost of planting, harvesting, and storing the crops, or the cost of purchasing forage from another producer.

MS. TAYLOR: Excuse me, Mr. Bushey. I hate to interrupt. Could you slow down a little bit for our court reporter?

THE WITNESS: Sure.

THE COURT: Thanks.

THE WITNESS: It gets kind of technical in here.

The capitalized cost of forages may also include costs such as interest, labor, and depreciation that is directly attributed to the raising of the crops for forage. These costs are expensed over time as the forages are fed to cattle. Feed inventory is shown at the lower of cost or market using the average cost method.

In addition, depreciation is adjusted to reflect the more accurate useful life. The tax basis to depreciation is accelerated and allows for a higher expense recognition in the initial year of placing an asset in service.

However, the GAAP standards require that depreciation should be distributed over the useful life of an asset. This results in a more consistent and reliable metric to match the cost of a capital asset to the revenue produced by that asset.

Generally Accepted Accounting Principles maintain that livestock should be capitalized at the purchase price and depreciated similar to machinery and equipment and other capital assets.

However, a well-maintained dairy herd does not lose value over time. Although individual dairy cows do depreciate, the herd, as a whole, does not. Lowering --

lower-performing cows are constantly replaced with higher-performing cows. Therefore, the dairy herd is valued at cost on the balance sheet.

If the dairy purchases milking cows, the cost is the purchase price of the livestock. If the dairy raises their own heifers, any heifer-raising input costs such as feed and breeding are capitalized to the cost of heifers until they first calve and become begin milking. At that point, the heifers are transferred to the dairy livestock at cost to raise -- at the cost to raise them to that point.

When cows are sold or die, a "cull cow expense" is charged to the operating expense at an average cost per head of the herd. Revenue received from the sale of cull cows is reported separately under the label "cull cow revenue." The financial statements value livestock at cost and are not depreciated, which constitutes a departure from GAAP.

These are the main accounting adjustments that are required to adjust from tax basis to GAAP financial statements. The final product each quarter is a financial statement which comprises a balance sheet, a statement of income, and a statement of changes in members' equity. Additionally, a statement of cash flows and notes to the financial statement are included at year-end.

One of the greatest services we offer to clients is a comprehensive dairy financial benchmarking and averages. The dairy averages provide a reliable dataset clients can use for benchmarking their own financial results to their peers. This allows them to compare their performance with the industry standards and identify areas for improvements.

We publish the dairy averages every quarter after the preparation of the financial statements. These averages contain both financial and non-financial metrics. Below is a table showing key non-financial information for the selected years 2007 through 2022.

I'll skip over the chart.

The dairy averages consist of operating revenue and expenses calculated per hundred pounds (or CWT) of milk produced per cow, per day. Each client receives this schedule in the supplementary information of their financial statements showing their actual performance compared to the latest averages.

The per CWT transactions are used to analyze trends in expenses. The three largest expenses are: Feed, labor, and cull cow expense, or herd replacement cost. Breaking those down per CWT produced reveals the change in cost over the years. Chart 1 shows this information from 2006 through the first quarter of 2023.

Most of our dairy clients are family-owned limited liability companies, or LLCs. LLC members do not take a wage for their work they perform, instead they take a withdrawal to cover family living costs.

Included in Chart 1 is also the average withdrawals per CWT taken by the owners. This is net of any capital they contributed to their farm in each year. These withdrawals are not reflected in the net income from operations, but still may be taken into consideration when looking at how industry decisions will impact producers' ability to provide for their living.

As shown in Chart 1 above, the feed expense per CWT has increased every year since 2018, jumping dramatically from 2021 to 2022. As the largest and most volatile expense account, feed expense greatly impacts the profitability of the producer. Labor has also seen an upward trend per CWT.

The trends in per CWT revenues and expenses reveal how the milk price received compares to the price needed to break even. Break-even milk price is calculated -- is the calculated price at which the farm's operating revenues would equal their operating expenses, holding other revenues, expenses, and production constant.

At the break-even milk price, they would have shown neither profit nor loss from farm operations. The following Chart 2 compares the average milk price paid to producers to the average break-even from 2006 through the first quarter of 2023.

The difference between the actual milk price and the calculated break-even price shows the average profitability per unit of output for each year. Chart 3 below presents the average net income or loss from operations per CWT over the same range of years as before.

Average net operating income from 2006 through

2022 was $1.54 per CWT produced, or per hundredweight, of milk produced. Consider also that this number is before any withdrawals by the producer to compensate their labor and provide for their family living expenses. The average net withdrawals from 2006 through 2022 was $0.31 per CWT of milk produced. This leaves $1.23 per CWT of milk produced remaining after family living.

As shown, these dairy averages are not only valuable for producers but also for understanding the profitability and trends in the industry. By providing accurate and reliable financial information and meaningful benchmarks, our data can help inform you as you consider these proposals.

I thank you for your time and attention to these matters and look forward to answering your questions.

BY MS. HANCOCK:

Q. Thank you, Mr. Bushey. I just have a few questions.

On the first page of your testimony you talk about the process begins by receiving quarterly data from our dairy client.

And I'm just wondering, it's not just one client, is it, it is multiple?

A. Yes. It's approximately 50 clients that we work with right now.

Q. Okay. And then on that first page as well, you said you were provided with a sample dairy financial statement. Is that one of the attachments that you have

included with your testimony?
A. Yes. That was one of the exhibits you referenced earlier.
Q. Is that Exhibit 152, which is identified as NMPF-26A?
A. Happy Cow Dairy?
Q. Yes.
A. Yes.
Q. Okay. Can you walk us through that exhibit and let us know what it is that you are showing us with this exhibit?
A. So we use this as promotional material when we're talking with potential clients and also with financial institutions when they are asking us what kind of information can we provide.
So page 5 -- I believe there's page numbers in the bottom of the exhibit.
Q. It is the balance sheet?
A. Yes.
Q. Yep.
A. Page 5, the balance sheet.
So this is a standard balance sheet that you would see with most industries.
And then page 6 is the statement of income, which I think is what we're focused on. So this is a sample of that statement of income. Again, these aren't real numbers. These are just numbers that we have just -- you can see it is all round numbers. It's just things we have

used for a sample.

Page 7 is that statement of changes in members' equity that we talked about earlier in my testimony.

Page 8 would be the statement of cash flows. So those are the four basic -- page 8 and 9 is the statement of cash flows, which are the four basic financial statements.

Then page 10 through page 18, basically the notes to a financial statement.

And then after that we get into page 19 is the supplementary information. So this is some of the more unique data that we would provide.

And so this is a year end financial statement. And what we will generally do is, also, besides providing that page 5 balance sheet, page 20 shows what we call a schedule of assets, liabilities, and net worth, which is this is now on the basically estimated current value method, whereas page 5 was based on cost.

So here we're trying to determine if a producer were to sell the -- sell their farm, or we use this also in succession planning, we use it for estate planning, you know, what's their estate worth, what's their net worth. So the bottom line on this schedule shows the net worth, of the operation.

Then pages 21 through 23 are just notes to those -- to that schedule 20, which basically defines how all those values were determined. Page 24 is just a reconciliation from one year to the next to show a producer how their values increased or decreased.

Page 25 is a schedule of capitalized forage costs. This is a schedule where we tried to be transparent and how did -- the value of the forages, how are those determined. So every quarter all the costs that are associated with growing forages are accumulated onto this capitalized forage cost and then they are attributed to the inventory.

Page 26 is another important schedule. This is a schedule of feed expense, since it's one of the most -- it is the most highest expense that the dairy by far has. We tried to break that down so that producers can understand what is their cost, where is it coming from.

So at the top portion of this schedule on page 26 is the forages used. So these are the forages that a producer would have on their farm, and they are using out of their own -- their own bunker silos generally.

And then other feed purchased would be if they are purchasing it from other farms and/or other suppliers, so they would have their purchased feed costs.

Then we also -- when we are trying to determine what's their cost of milking cows, we want to take out any cost that's associated with the heifers. So at the -- towards the bottom of page 26, you see an adjustment, and it shows heifer feed adjustment. We're subtracting out the estimated cost of feeding the heifers. So that feed comes out of there. So we're only then talking about feed that went to the dairy cows.

And we reconcile that at the bottom with the average number of cows on the farm for each period number of days and come up with a -- a cost per cow per day so we can kind of see how does that look from period to period, and then how does that look to their different -- to their average to their peers.

Page 27 is that schedule of capitalized heifer raising costs. So this is where all the costs of raising the heifers is accumulated. So, again, these costs are accumulated outside of the cost of just milking the cows. So we're segregating those costs out, adding these in, to come up with what does it cost to raise a heifer, so that way we'll know what's the value of the heifer when she enters the herd.

And then page 28, 29, and 30, basically what we call a schedule of income and expenses per hundredweight of milk produced, and we also have it listed as a per cow per day. And we started listing it also -- so it is per milk delivered and also energy-corrected milk.

So you will see on page 30 is where we would then compare the client's data, which is in this case Happy Cow Dairy, with on the right-hand column is the Nietzke & Faupel, PC, in this case under 2,000 cows averages. So this is where we start to compare client's data with the benchmark data.

Q. Okay. And -- and remind me again how it is that you -- that you create your benchmark data?

A. I'm sorry, in what way?

Q. What's all included in that? How do you create that benchmark for them?
A. So we take each client's basically schedule that you see here on page 30, on the left-hand column, we add those all together, and divide them out to get the average.
Is that what you are asking?
Q. Yep. Exactly.
And do you divide -- how do you divide that up? How do you -- is it divided up by a per cow basis or how did you divide that up?
A. Yes.
Q. So is the purpose of you including Exhibit 152 as part of your testimony just to highlight the level of detail and information that you collect from each one of your clients?
A. That's correct.
Q. And then you use that amalgamated data to create that -- that control or that compare set so that your individual client knows how they are stacking up against the total grouping?
A. Yes.
Q. And that way they know if they are trending above or below or more efficient or less efficient, to give them some insights into making some business decisions; is that fair?
A. Yes, that's fair. That's correct.
Q. Okay. And then let's look at Exhibit 153, and

walk me through what we're looking at in this exhibit.
A. So this is a Nietzke & Faupel, PC, dairy averages. I don't have the Exhibit Numbers on my copy. That's --
Q. Yes, that's the right one. And this is identified as NMPF-26B, which we have marked as Exhibit 153 for our record.
A. So this is the accumulation of the whole year of all the dairies that -- from all the dairies of our clients through the year end of December 31st, 2022, and then it's also compared with the year ended December 31st, 2021.
And so we start out at the top line there with -- starting over on the left-hand column, quantity of milk and CWT. So we measure that. We add those all up and divide them by the number of dairies there, so we got 995,115 hundredweights of milk produced on average there.
We have the average number of cows milked per day of 3,354.
So then we do a little math there. We divide that into that 995, and we divide it by the number of days of 365, to come up with 81 pounds of milk produced per cow, per day.
We take the number of cull cows there is just a metric there that we like to measure. So we take that 1523, add -- we, again, do some math, divide that by the total cows, and come up with an average then cull rate for the farm of 38.73%.
Just for reference, then, the average number of

mature animals on the farm would be 3,932. And then, again, the number of days in the period there, 365, and then we get to the break-even milk price of $19.78.

We also have a break-even production per cow per day there. And that varies quite significantly based on the milk price. You can see here in 2022 it was 64 pounds.

Moving down to the revenue from operations. So we have milk revenue there, focusing on, again, that per delivered CWT produced column. So it's $25.28 was the average milk price received there for the year.

Q. And is that -- I'm sorry, just to interrupt one moment -- is that still all under that year end December 31st, 2022?

A. Yes.

Q. Okay. So we're just going to look at those, those three main columns going straight down under that?

A. Yes.

Q. I guess it would be four columns. I apologize.

Amount, per delivered hundredweight, per energy-corrected hundredweight produced, and per cow per day, all four of those columns fall under that year end, 2022?

A. That's correct.

Q. Okay. I apologize for interrupting. Go ahead.

A. So just focusing on that column of per delivered CWT produced there, you can see the livestock revenue of $0.52, the cull cow revenue of $1.14, and other income there $0.65. So a total revenue to the operations there of $27.59.

And then you can see the operating cost. I won't read every one of them to you. You can see the total operating cost at the bottom is $22.09.

So then subtracting that from the total revenue from operations of $27.59, we get $5.50 income from operations. And, again, that was before the family withdrawals.

And to get the break-even milk price, we simply then say, they made $5.50, so to break even we would take the milk price of $25.28, we subtract $5.50 from that, and we get the $19.78. So in other words, if they got $19.78, they would beak even in that period.

Q. Okay. And then -- and this is the data that you used in -- in your Exhibit 151, which is your written testimony?

A. That's correct.

Q. Okay. And if we go on to the next page, you just have different time periods for each year, and you are just comparing two years at a time?

A. That's right.

Q. Okay. And if we just go all the way back, it looks like the last page --or the next -- next to the last page takes us back to 2007.

A. And, actually, I think you should have a page 2006. Does it go back that far?

Q. Well, I guess the comparison of the two years, I

have it goes back to 2007, and then there's a final page that just shows all entries for 2006.
Is that how yours is as well?
A. Yes.
Q. Okay. And this is all based on actual data that you have collected over all of those years from 2006 through 2022?
A. That's correct.
Q. And in 2022, we saw that milk prices -- and we heard testimony on this -- were doing very well that last year?
A. That's correct.
Q. And that's what you have reflected here in this $5.50 a hundredweight net income?
A. That's correct.
Q. And what are you seeing happening so far in 2023?
A. Well, the first quarter was still some profit, but I -- we don't have the numbers all collected for the second quarter, but it's not looking that good.
Q. And I just want to look at a couple of the charts that you have.
If we look at Chart 1, and you were graphing there the feed expense per hundredweight; is that right? And I'm on page 4 of your testimony.
A. Yes. So the top line of that chart is the feed expense. Then there's three other lines there that they don't show as much change there. It's a little bit harder to see because the change is a little bit more minute.

But we're also showing the cull cow expense, the labor, benefits, and taxes, and then also the producer withdrawals --
Q. Okay.
A. -- were shown on there.
Q. And your first line of text on that page says that "as shown in Chart 1 above, feed expenses per hundredweight has increased every year since 2018."
That's -- and that's just following a few years -- a couple of years' worth of a drop in prices; is that right?
A. That's right.
Q. But then when it increased again since 2018, it's continued to go up and surpass even the high point from before; is that right?
A. That's correct.
Q. And so the overall trend is that feed prices over the years have gone up without -- without ever netting back down lower than where they originated?
A. Yeah. Yeah. I think if you would start back in 2006, you can see that it makes a -- a pretty clear upward trend there.
Q. And then it looks to me like the other -- the other items for cull cow expense and labor have been, at least based on the lens that we're looking through here, doesn't reflect a whole lot of change; is that fair?
A. Yeah, that's fair. It is a little hard to see that because it's -- we probably need a bigger chart.

Q. Well, that was going to be my question. If we zoomed in to smaller increments, we would be able to see the volatility a little closer; is that right?
A. That is right.
Q. Okay. And then when we look at the producers' withdrawals, that net there, that's what you said was the amount that the dairy farmers take out for just their everyday family expenses; is that right?
A. Yes.
Q. And most of us in -- in the non-dairy world kind of hope that our salary will increase year over year to at least keep up with inflationary growth. Is that fair?
A. That's fair.
Q. The cost of living that we hope to get each year?
A. Uh-huh.
Q. You have to answer audibly for the record.
A. Yes.
Q. Okay. And it looks like here, the producers' withdrawals have either maintained pretty flat or even dropped down; is that fair?
A. That's fair on a per hundredweight of milk produced, yes.
Q. So would you say that this is reflecting the dairy producers are not receiving that cost of living increase that would be keeping up with the inflationary standard?
A. Yes. Except that's if you -- on average, our dairy herds have gotten larger, so they have been able to expand their way to make up for that.

Q. And that's where I was going to go next, which is, is it dependent on them being able to expand in order to create their own cost of living increase or to -- in order to kind of maintain the same standard of living?
A. Yes.
Q. And if they are, for example, not able to increase their herd size, then -- then -- then they are not able to keep up with that cost of living increase?
A. Yes, I would agree.
Q. Okay.
MS. HANCOCK: That's all I have, your Honor. I would offer Mr. Bushey for cross-examination.
THE COURT: Mr. English.

CROSS-EXAMINATION

BY MR. ENGLISH:
Q. Good afternoon, Mr. Bushey. By name is Chip English. I'm an attorney for Milk Innovation Group. And thank you for being here today. I have been doing this for just a little while, and I will say that clearly over time the sophistication of these financial statements has clearly gotten better, for what it's worth.
I just have a few questions. And I may not have heard -- I'm going to ask the first one, and if I didn't hear the answer, I apologize.
But looking at Exhibit 153, in the very middle you have the term "energy-corrected."
A. Yes.
Q. And then there's an asterisk, and the asterisk

below says "corrected to 3.5% butterfat and 3.2% protein."
A. Yes.
Q. Okay. So I guess this is the first time I have heard the term "energy-corrected" as opposed to what we use.
So could you explain why you used phrase "energy-corrected"?
A. I'm not exactly sure. I know that a lot of nutritionists who help feed the cows, and that's where we found some of these calculations to come up with that. They want to correct the milk to basically make all producers' milk look the same. So taking it to a 3.5 butterfat and to a 3.2 protein is kind of some -- in some ways a standard. There's some standards that say 3.0 protein.
Q. I appreciate that. I mean, listen, standardization and GAAP, it's just the phrase "energy-corrected," so I was just trying to understand. When I looked at the phrase in the footnote, it didn't -- it didn't immediately resonate with me. So thank you.
So you have -- you have got over 50 large dairies as your clients. Are any of these that are included in this material today organic?
A. No, I don't believe so.
Q. Are any of them A2 milk?
A. No.
Q. Are any of them pasture-fed milk?

A. Pardon me?
Q. Pasture-fed.
A. No, not that -- I don't believe so.
Q. Is that because they have a different business model structure?
A. I'm not sure. We just don't -- we have a couple of organic dairies, but we don't actually use this kind of information for them.
Q. Okay. So I want to pick up where you left off with Ms. Hancock and the commentary that the living expenses go up -- you know, are flat unless they grow.
The reality is, if you look at your materials, especially page 3 of page 5 of the testimony, when I look at the quantity of milk in hundredweight from 2007 to 2022, on average, they have tripled, correct?
A. Correct.
Q. Okay. So that $0.31 per hundredweight is now on almost a million hundredweight, correct?
A. Yes, that's the math.
Q. And that's the living expense portion, correct?
A. That's their -- what we claim -- we call their withdrawals. I mean, we can't determine exactly what they are using it for, but they take it out of the business.
Q. Right. But -- but that -- that still leaves, in your own statement, $1.23 per hundredweight, correct?
A. Correct.
Q. And so if you -- if you calculated, say, $1.23 -- and let's just use 2022 -- if you multiplied that by the

995,115 hundredweight, that would come out somewhere north of $1.2 million, correct?

(Court Reporter clarification.)

BY MR. ENGLISH:

Q. If you look at page 3 --

A. Okay.

Q. -- your testimony at page 3. And you have got the quantity of milk in hundredweight, last column -- I'm just going to do one year, I'm not going to try to go through all of them -- just quantity of milk in hundredweight, the column under 2022 where it's 995,115 hundredweight?

A. Yes.

Q. After you have accounted for the $0.31 per hundredweight average net withdrawals?

A. Uh-huh.

Q. You have got $1.23 per hundredweight. If you multiply $1.23 a hundredweight by that first line of 995,115, you are going to come up with a number larger than 1.2 million, aren't you?

A. Yes. That's the math.

Q. And that's in addition to their withdrawals for family living, correct?

A. Correct.

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

THE COURT: Any further questions, other than AMS?

Mr. Miltner.

CROSS-EXAMINATION

BY MR. MILTNER:

Q. Good afternoon, Mr. Bushey. Ryan Miltner representing Select Milk.
USDA's helping me get a previous exhibit that I wanted to ask you some questions about as well, but while that is getting ready, we can start with a few other questions.
When you say your clients are the Great Lakes region, that would include Michigan and Ohio. Are there any other states where you -- where your firm has clients?
A. Yes.
Q. What states would that include?
A. It includes some in Indiana here, Wisconsin. And we do have a few clients spread out. I believe one in Minnesota, one in Kansas.
Q. Great.
Are all of those dairies included in the data represented in Exhibit 153?
A. Most of them.
Q. And just to be clear when, when you refer to the steps you take to ensure accuracy and completeness of data, that's different from an audited financial statement, right?
A. That's right.
Q. Okay.
MR. MILTNER: Your Honor, could I approach the witness to hand him this exhibit?
THE COURT: Yes.
MR. MILTNER: Thank you. It's Exhibit 84 that was

introduced, I think, last week. It's also noted as NMPF-25E.
BY MR. MILTNER:
Q. Mr. Bushey, are you familiar with the accounting firm Frazer, LLP?
A. Yes.
Q. Am I correct that generally the dairy clients that your firm works with are not in the same region of the country as the -- as Frazer's clients?
A. I would agree with that.
Q. Do you have a generally favorable opinion of the work that Frazer does?
A. Yes, I think they do good work.
Q. Great.
A. Yes.
Q. And both of your firm and Frazer specialize in accounting for dairy farms, correct?
A. I know what our firm does. I believe they do. I can't speak for them.
Q. Okay. You're aware that they do a lot of work with dairies?
A. Yes.
Q. I just gave you an exhibit, which is Exhibit 84, and it's titled Dairy Farm Operating Trends, December 31, 2022. And what I'd like to spend a few minutes doing is trying to see if -- if we can try to match up some of your data with theirs because they are -- I find them very similar. Okay?

A. Okay.

Q. So if you would turn to what is numbered page 5 of that document, and the top of that page reads "Condensed Statement of Dairy Farm Income and Costs." Let me know when you've found that.

A. Okay. I have it.

Q. So that has columns Southern California, San Joaquin Valley, and Kern County.

Do you see that?

A. Yes.

Q. Okay. So here's the assumption that I want to make. And I'm not asking you to agree that my assumption is correct, but for our exercise, let's do so.

I want to assume that both Frazer and Nietzke & Faupel accurately measure the bottom line figure of their clients, and that the line four lines from the bottom, total cost of operations, is the same as what you have measured on Exhibit 153, total operating costs and expenses. So assume you're both trying to get to the same point and you have achieved that. Okay?

A. Okay.

Q. Now, what I want to do, if you can manage to leave that open, and also pick up your Exhibit 153, which are your averages.

A. Okay.

Q. And what I want to do is go through your -- we're going to start with revenue items and go down through costs and expenses, and I want to ask you about what your

title is and tell me where you think that would fit on Frazer's category. And some will be real easy, and some you're just going to have to give me your best judgment as to where you would shove that. Okay?
A. Okay.
Q. So let's start with milk on yours.
I assume -- and I would put that under milk sales on the Frazer column.
Would you agree?
A. Yes.
Q. And then, livestock, cull cows, and other income on yours, I would lump that under calves and other because it's the only other income figure.
Would you agree with that?
A. Yeah, with the exception of, I'm not sure on cull cows how they are handling that, because they do have a herd replacement cost, so I'm not sure if they are netting some of that into there.
Q. Okay. That's a good call-out.
So let's go down to operating costs and expenses.
You have a line item for animal health?
A. Yes.
Q. Given the dozen or so cost items -- well, a few more than that -- but given the cost items that are on the Frazer exhibit, where would you think animal health would best fit?
A. I think they have kind of combined a couple of our accounts in veterinarian and breeding and testing. And so

we have animal health, and down a couple lines is breeding. I would group those two together.
Q. And you would put them in the veterinary breeding and testing?
A. Yes.
Q. How about your line item for bedding?
A. Yeah. I'm not sure where they would put that. They may have that in that same line item or -- I don't know where it would be, supplies.
One of my, I think -- I'm not very familiar with Southern California, but I believe a lot of their dairies do not have freestall barns, they are dry lots.
Q. Right.
A. So they may not have a lot of bedding. That might just be a cost that they don't have.
Q. Can we -- can we put it under miscellaneous then, since we don't know exactly where it goes?
A. Sure.
Q. Okay. We talked about breeding expense, and you have a line item for cull cow expense. And that was what you mentioned about netting out those two items, correct?
A. Yes.
Q. Do you see a good spot where that might fit -- I guess they have a herd replacement cost figure on the Frazer exhibit.
A. That's right.
Q. Would -- well, where -- how would you net that out, if you were trying to do so?

A. I guess I would take the $2.74 and subtract the cull cow revenue of $1.14, come up with -- what would that be, $1.60-something -- $1.58, something like that.
Q. Whatever the math is, you would take the cull cow expense, reduce the cull cow revenue, and that net number becomes a herd replacement cost, if you are -- if you are looking at Frazer's?
A. Yes.
Q. Okay. Waste removal might be another one that cost varies by operation.
But custom hire waste removal, do you have a spot where that might fit best?
A. Again, it would be -- we're comparing these to California dairies with dry lots. I don't know -- I don't think they have a lot of waste removal issues there.
Q. Okay. So in the absence of a better category, maybe miscellaneous again?
A. Sure.
Q. Okay. Depreciation. There's a depreciation category.
That would seem to fit well, yes?
A. Yes. I do have a caveat here. It says depreciation of equipment. So I'm not sure where they are -- again, that may be -- they might not have a lot of other buildings and barns and things like that in California, so --
Q. Okay.
A. It's a little hard to compare.

Q. We have a single line on yours for feed. They appear to break it down between grain and hay and other.
But we think we know where feed would go, right?
A. Right.
Q. You have a line item for fuel. You also have a line item for utilities.
I don't see a fuel expense on Frazer's. Do you have a thought as to where you might categorize that?
A. No, I don't know where they --
Q. Okay.
A. No.
Q. Insurance, there's a -- we have a line item for insurance I thought I saw.
A. No.
Q. Oh, we have a line item for hauling, so we know where that goes.
Insurance, could we put that under miscellaneous?
A. Well, they may have some of those types of costs in occupancy costs, so it could be in there.
Q. Okay. There is a line item for interest, which matches up.
There is labor, benefits, and taxes. And on yours they have labor including fringe costs.
So do you think that matches up well?
A. Yes.
Q. Lease and rent.
A. Again, I think that would go into their occupancy cost.

Q. Okay. Marketing and promotion?
A. That's probably under their state and association charges. I'm assuming.
Q. You have a miscellaneous line also, professional fees and DHIA?
A. That may go under that state association charges. I'm not sure how they handle that.
Q. Okay. Repairs and maintenance, those categories match up very well, as does supplies.
And then taxes, I didn't see a line item on there for taxes under Frazer's.
A. Taxes are generally property taxes, so that may be part of that occupancy cost again.
Q. Okay.
A. And, again, they may not have as much with dry lots.
Q. So assuming we could then lump -- we could match up categories to -- with some level of logic, if not accuracy and precision, do you think that we would have a fair comparison between a Great Lakes region income and expense and profitability, along with the western states that are included on the page you are looking at, and then also the following page has some other regions?
A. Well, because there's some significant differences in whether you have a dry lot or you have freestall barns, I think there's some -- some major differences in expenses. And it looks to me like feed costs is quite -- quite a bit higher there than what we see here with a lot

of our producers producing their own forages, so that kind of changes things. I'm not sure how good of a comparison you can get other than maybe just looking at total expense.

Q. But I guess from the -- from the bottom line, would you think we would have a fair gauge?

A. I think, again, looking at just maybe their total operating costs compared to the total operating cost and expense would be a little easier to make a comparison.

Q. Okay. Thanks.

MR. MILTNER: I don't think I have anything else for you.

THE COURT: We have been going a little more than an hour and a half. Can we take a ten-minute break? Let's come back at 3:26.

(Whereupon, a break was taken.)

THE COURT: Back on the record.

Any further questions in the nature of cross-examination, not from AMS, for this witness?

No one? AMS.

CROSS-EXAMINATION

BY MS. TAYLOR:

Q. Good afternoon. Thank you for coming to testify today. Just a couple quick questions to clear up a few things.

On page 3, when you have your chart of your averages?

A. Yes.

Q. And I know you said you have about 50 clients. Do these averages represent all 50 clients or a portion of them?
A. 50 clients. But -- so from 2007 through 2022 it would be maybe not the same 50 all the time, because there's clients coming and going.
Q. Sure. Okay.
And I see -- well, I won't ask that question. I think I know the answer.
Okay. I wanted to turn to your next Chart 1 on page 4.
A. Okay.
Q. And you have a line for labor, benefits, and taxes. But I assume that's not family labor, so that's other employees?
A. That's correct.
Q. Okay.
A. In most cases.
Q. In most cases.
A. There might be a few clients that are incorporated and take a wage, but in most cases it is just other labor.
Q. Okay. And then on your break-even chart down there, Chart 2, does the break-even include somewhere the family withdrawals?
A. No.
Q. Okay. So that's not -- so you might have a break-even price, but that doesn't include your family living expenses?

A. That's correct.
Q. And I wanted to compare kind of what's represented on this chart with what you have in your table on what is Exhibit 153 or 26B.
And under revenue, I take it from some questions and answers from other attorneys, that the revenue from -- represented in this break-even price is only the milk side it doesn't include livestock, cull cows, and other income?
A. Which revenue are you referring to?
Q. Well, when you went over -- on Exhibit 26B, when you were discussing how you came up with the break-even price there of $19.78, I believe what you said is you took the $25.28 minus the $5.50 income or loss that was at the bottom of that column, and that's how you got to $19.78.
Would that be correct?
A. That's correct.
Q. So that's not factoring in these other kind of revenue sources?
A. Well, it is factoring in other revenue sources since it is -- those other revenue sources are allowing that break-even to be lower.
Another way to look at it would be the total operating costs and expenses are $22.09, but we're seeing the break-even is $19.78. So the difference between that cost and the $19.78 is that other revenue.
So the other revenue is allowing a lower break-even because they do have that other revenue there to help offset some of those costs, if that makes sense.

Q. Yeah, I follow that. Thank you.
I was curious, in any of this, because I know there were government targeted payments for dairy producers in '21 and '22. Is that accounted for anywhere here?
A. Yes. That is in the other income.
Q. Okay.
A. And if you turn to the next page, and you will see in the year ended December 31st, 2020, the other income was significantly higher. That's where most of the dairies collected a lot of their government payments in 2020.
Q. Okay. And so this is when they collected them, right? That's on a cash basis, when money came in the door, not necessarily for the time period that the payment was to reflect for them. Does that make sense to you?
A. It makes sense, but I'm not sure on that. We do try to basically report the revenue in the time period it was earned.
Q. It was earned, okay.
A. So that's what we're trying to do. I'm not saying we get perfect, but that's what we're trying to do.
Q. Okay.
And on the final chart, just so I'm clear -- and I think it's the same answer -- this doesn't include withdrawals for family labor, that net income line?
A. That's correct.
Q. Okay. And so would it be correct if I read this,

I think you said the average operating income was $1.54; then if you include withdrawals, it was $1.23.
If I were to look over this chart over time, then operating income ranged during this time period anywhere from a low of negative $3 to a high of positive $6?
A. Yes.
MS. TAYLOR: I think Mr. Wilson has a couple questions.

CROSS-EXAMINATION

BY MR. WILSON:
Q. Good afternoon.
Just one quick question just to -- for clarification. For the year 2020 ending, you have two columns of metrics: One as-delivered, one energy-corrected; is that correct?
A. Yes.
Q. The other years you only have one column. Is that -- do those other years compare with the as-delivered reference in 2022?
A. Yes. Yes, we just started adding that column for the energy corrected in 2022, so that's why it only shows up in that --
Q. Thank you.
A. -- period.
MS. TAYLOR: That's it from AMS. Thank you.
THE COURT: No other questions?
Ms. Hancock.

REDIRECT EXAMINATION

BY MS. HANCOCK:
Q. Thank you, Mr. Bushey. I -- I have a question. If you have what we have marked as Exhibit 153, this is the Nietzke & Faupel December 31, 2022 and 2021 averages, on the first page?
A. Yes.
Q. And it shows, for 2022, that the net income from operations on a per hundredweight basis was $5.50 in 2022; is that right?
A. Yes.
Q. That was kind of an exceptional year; would you agree?
A. It was a great year.
Q. Okay.
A. Our clients were happy.
Q. And if we look at 2021, it was $0.96 per hundredweight; is that right?
A. That's right.
Q. Okay. So it's not that great of a year that year.
A. No. Early 2020, if you look at that, the government program payments really made that year. That's exactly what their income is, really, the owner income.
Q. Okay. So when we see the net income in -- on the second page there of $1.43 a hundredweight, you are saying that's from the government subsidies that were paid out?
A. Most of it, right.
Q. Okay. And if you didn't have that subsidy in that year, it would be close to zero or a loss?

A. Well, it probably wouldn't be a loss, but it would be, yeah, close to zero. There's some other income in that other income, so wouldn't have all -- wasn't all government payments, but a lot of it was.
Q. And if we look at, for example, 2018, it was a loss on a per hundredweight basis, and that's $0.48 a hundredweight that was a loss that year?
A. That's correct.
Q. Okay. And then just looking at the next page on 2016, was a positive but only $0.04?
A. Right. Basically break even.
Q. Or I should say $0.04, I'm sorry.
A. And keeping in mind, that's before family living withdrawals, so it would actually be negative, like in 2016.
Q. Okay.
And then Mr. English did a calculation with you based on the -- I think the $1.23 a hundredweight average net income based on your calculations between 2006 and 2022.
Do you recall that?
A. Yes.
Q. And I think the math that he did was $1.2 million in positive net income?
A. Yes.
Q. That doesn't take into account the capital investment that's required in order to maintain a dairy, does it?

A. Well, right. Most of that money is used to maintain or expand the dairies. Yes.
Q. Okay.
A. That's where that profit goes.
Q. Okay. And have you calculated an estimate of -- on a per-cow basis of what it takes in order to even have that capital investment?
A. Yeah. We have some of that data. I don't have it with me. But just to do a fast calculation, if we just assume some round numbers of investment of $2,000 per dairy animal, another roughly 1,000 on average for your young stock, so you're at 3. And you got facilities are probably going to cost $3500 a cow. Now we're at 6500. We're going to have investments in inventory, receivables, those types of things, all the feed they have to have, another $1.5 million. Now you are at 8. And then you got to have your land. Most of these farms have some land. I think that's what help keep their costs a little bit lower on the feed. Even another $2,000 for land. You are looking at $10,000 a cow investment.
Q. Okay. So if you had a herd size of, in 2022, which you said your average was 3,354, I believe, at $10,000 a cow, that's over $33 million capital investment that would be required to maintain a herd that large; is that right?
A. Yeah. And actually, when I was doing those calculations, I was assuming all mature animals, so we're probably closer to 4,000 -- I believe it's 3900 and

some -- 3932, so let's just say $4,000 an animal -- 4,000 animals.
Q. Okay. So you would be --
A. 40 million.
Q. 40 million capital investment for a 3300-cow herd; is that -- milking cow herd?
A. Right. That's correct.
Q. And -- and if I -- do you have a general rule of thumb, if I were to invest on the stock market, they say the average return -- rate of return should be somewhere around 8% over time; is that right?
A. My daughter's in wealth management, and she would know those numbers. I'll take your word for it on that.
Q. If I did the math correctly, you know, if it was 35 million or $40 million investment, that works out to be, at $1.2 million net income, about -- just at about 3% return on the investment; is that right?
A. Right.
Q. And that also takes into account where we have a really phenomenal year in there, 2022, which really helped increase that average; is that fair?
A. That's correct. Yes.
Q. Okay. So while $1.2 million net income might sound like a lot of money, when you look at the amount of invested capital that it takes to even get to that, there's not very much wiggle room in there, is there?
A. No.
Q. And -- okay. Thank you.

MS. HANCOCK: I think that's all I have. Appreciate your time today.

THE WITNESS: All right.

MS. HANCOCK: Your Honor, we would move to admit Exhibits 151, 152, and 153.

THE COURT: Seeing no objections, those exhibits are entered into the record in this proceeding.

(Thereafter, Exhibit Numbers 151, 152, and 153 were received into evidence.)

THE COURT: You may step down from the stand. Thanks for being here.

MS. HANCOCK: Your Honor, we will call Mr. Darin Hanson back to the stand as our next witness.

THE COURT: Welcome back, Mr. Hanson. Please raise your right hand.

DARIN HANSON

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

THE COURT: Your witness.

MS. HANCOCK: Thank you.

DIRECT EXAMINATION

BY MS. HANCOCK:

Q. Good afternoon, Mr. Hanson. I appreciate you being back again to testify with us.

You're here to talk today about Make Allowances; is that right?

A. Yes.

Q. And did you prepare a written statement on behalf

of National Milk related to your Make Allowance testimony?
A. I did.
Q. Is that what's been marked as Exhibit NMPF-16?
A. Yes.
MS. HANCOCK: Your Honor, if we could mark for identification purposes, I think we're at 154?
THE COURT: We are. So marked.
(Thereafter, Exhibit Number 154 was marked for identification.)
MS. HANCOCK: Thank you.
BY MS. HANCOCK:
Q. Would you proceed with giving us your statement?
A. Yes.
THE COURT: I'm sorry, do I have that?
Let's go off the record.
(Off the record.)
THE WITNESS: And like yesterday, I won't repeat my bio and company profile into the record.
Good afternoon. Again, my name is Darin Hanson, senior vice president of supply chain and risk management at Foremost Farms.
Foremost supports Proposal 7 to increase the Make Allowance in the butterfat, nonfat solids, protein, and other solids component formulas as recommended by National Milk. This includes raising butter to $0.21 per pound, nonfat dry milk to $0.21 per pound, cheese to $0.24 per pound, and dry whey to $0.23 per pound.
As other National Milk members have stated, these

allowances are a stretch for dairy producers to absorb with their thin margins, even though these proposed Make Allowance increases may not fully compensate for the cost increases realized by dairy processors in the manufacturing of dairy products. Instead, these allowance increases strike a fair balance, between the reduction in producer pay price and the reduction in processor milk costs resulting from these increasing Make Allowances.

Foremost plants have experienced higher operating costs due to inflation since 2008, but especially over the past two years. Labor, energy, packaging, capital, and other non-dairy costs have risen significantly during this time. It is fair to note that some of these costs have decreased in 2023. For example, natural gas prices have fallen back to pre-pandemic levels, and diesel costs, a large driver of hauling costs, have trended downward.

Allowing these proposed Make Allowance increases, while we work towards a mandatory audited survey of cost data, will balance the need for the increase while not devastating our producer market.

An important note is that manufacturing -- the manufacturing class Federal Order prices are not mandatory prices that are required to be paid by milk buyers to dairy producers. Payments to dairy producers can also include other pluses and minuses, such as volume premiums, quality incentives, hauling costs allocation, and market adjustments.

Also, milk customers can be charged a basis, or over-order premiums, that can be added to the milk price to account for higher increased costs as well. This basis can also be positive or negative. The level of the basis is determined by regional supply and demand factors and various other market factors.

If a processor is buying milk from a cooperative at agreed upon basis and their operating costs rise unexpectedly, the basis can be negotiated lower to offset some of these higher processor costs. This, in turn, may force the cooperative/processor to pay their members less for the milk produced by reducing member premiums. If the cooperative is also a processor, they may be required to pay less premiums to their members to ensure that earnings targets are met in the face of these higher operating costs.

With Make Allowances changing infrequently, customer basis and member milk premium programs allow parties to adapt to higher manufacturing costs over time in a natural way.

Since 2015, in the Midwest and the Mideast, customer basis has been declining, which has pressured member premiums for milk procurement to also go lower. This is partially in response to higher processor operating costs. Ideally, when Make Allowances are changed, customer basis and dairy producer premiums would adjust at the same time. However, since these premiums tend to change gradually over time, they are sticky and do not change quickly.

This may be due to contractual agreements between parties that lock in milk and finished product basis and overages. When these longer-term annual agreements are in place, it is difficult to adjust producer premiums without impacting earnings, because only one of the side of the equation is fixed.

In addition, milk supply may be slow to rebalance due to abrupt change to producer pay prices, as it takes a long time to ramp down or back up when prices recover. Large increases to Make Allowances would be a good example of an abrupt change to producer prices, and such a change would likely force changes to farming operations.

Due to financial pressures of lower milk prices resulting from a large Make Allowance increase, dairy producers may decide to reduce cow numbers or exit the industry altogether, at a time when processors are incentivized to ramp up production.

This would disrupt supply and pressure milk premiums and customer basis levels to move higher as processors compete for milk, partially or totally offsetting the impact of the Make Allowance change.

If Make Allowance changes are implemented, the full impact to the milk price will be felt by dairy producers immediately. The milk premiums to dairy producers and basis to customers would be much slower to adjust. This is an important reason to limit the magnitude of the Make Allowance change to ensure that markets remain orderly and not disruptive to dairy producers.

Foremost also supports the recommendation for mandatory USDA plant cost surveys to ensure that Make Allowance calculations are as accurate as possible. Costs will change over time with inflation, consistently causing some costs to go higher. For other costs, such as energy, costs can increase and decrease from year to year. A consistent and robust survey process that refreshes the manufacturing cost data on a timely basis is critical to the validity of the Make Allowance values.

In summary, Foremost supports the National Milk proposal to increase Make Allowances. The proposed change directionally accounts for changes in higher operational costs experienced by processors, while minimizing the impact in financial disruption to dairy producer pay prices.

The reality is that there are other mechanisms to account for higher operating costs for processors, including the customer basis and milk premium programs for dairy producers. These likely have been adjusted lower over the years to reduce the impact of higher processor operating costs. The key is to adjust Make Allowances to better represent reality, but ensure an orderly marketplace for dairy producers. Thank you.

MS. HANCOCK: Thank you, Mr. Hanson.

Your Honor, we would make him available for cross-examination.

THE COURT: Mr. Rosenbaum.

CROSS-EXAMINATION

BY MR. ROSENBAUM:

Q. Steve Rosenbaum for the International Dairy Foods Association.

Mr. Hanson, on page 2, you say that diesel fuel costs, a large driver of hauling costs, have trended downward, correct?

A. Yeah, versus last year.

Q. And what line item is that in in the calculation of Make Allowances?

A. I'm not -- just energy costs, in general, I mean.

Q. Well, you said hauling -- you said diesel fuel costs, a large driver of hauling costs, have trended downward. I'm trying to figure out whether that has anything to do with Make Allowances whatsoever. Does it?

A. I don't know the specifics of what goes into the calculation, but I mean, it's a very significant cost that we incur as milk processors just to get the milk to the plant.

Q. On that same page you make the statement, quote, "an important note is that manufacturing class FMMO prices are not mandatory prices that are acquired to be paid by milk buyers to dairy producers," end quote.

Is that sentence presupposing that the milk buyer has depooled?

A. Could be -- that could be a situation.

Q. Well, if you -- if you haven't depooled, if you are a regulated handler, I thought FMMO prices are

mandatory. I thought that was the whole point the system.
A. I believe that if they are -- well, if they are pooled, and they contract directly with independent dairy producers, then I believe there is a minimum that they have to provide. But if they are contracting with cooperatives, they -- they can buy milk under class.
Q. You mean -- you are talking about a situation in which the handler, the regulated handler, is the cooperative itself; is that what you are saying?
A. No. No.
Q. You -- it's your understanding that proprietary -- a proprietary handler contracting with a cooperative for a milk supply for Class III purposes is not required to pay the minimum Class III price?
A. That's what I understand and experience. I mean, definitely on a spot basis.
Q. Sorry, I couldn't hear you.
A. Definitely on a spot basis, you know, you are selling milk under class just to, you know, market the milk. And even when you get to contract basis.
Q. Are you aware that -- is it your view that there's a contract exception to the minimum milk price requirement?
A. I'm aware that there -- if you have a private processor, working with a cooperative, that's -- it is -- different rules apply for the contracting price.
Q. Do you have any particular regulation or statute to cite for these propositions?

A. No.

MR. ROSENBAUM: That's all I have.

THE WITNESS: Okay.

THE COURT: Questions from others?

CROSS-EXAMINATION

BY MR. ENGLISH:

Q. This is Chip English for the Milk Innovation Group.

Good afternoon, Mr. Hanson, again.

A. Good afternoon.

Q. So I think I figured it out, but I was puzzling over the use of the phrase because I don't think I have seen it yet in this proceeding. But several times on page 3, in the long paragraph for Exhibit 154, you discuss a term called "customer basis."

And I'm -- I am figuring that what you mean is the value -- the price that people are willing to pay in total is declining.

A. Yeah. I was counselled to use that term instead of over-order premium.

Q. I don't want to know what the lawyer told you but -- but -- but -- so it's -- it is another term for over-order premium; is that what you mean?

A. Yes. It was to avoid confusion, because you always assume over-order premiums are positive, but over-order premiums can be negative, too. You can add a positive number or you can add a negative number.

Q. And, in fact, they have been negative in the Upper

Midwest, correct?
A. Yeah, this year.
Q. And so if Make Allowances were adjusted upward, to the extent that customer basis has been negative, the market value of the milk will remain, correct, the market value? It will still be the market value?
A. Yes.
Q. Okay. So wouldn't you expect if the Make Allowances went up, if customer basis is negative, that that customer basis would adjust with the Make Allowances going up, correct?
A. Yes, I would expect that. That's kind of the point of that paragraph, kind of the opposite direction, where it said that those basis levels have been declining. Where the opposite reason, so if you shift -- if you increase the Make Allowance, then over time, you would think that you would start to see an increase in those over-order premiums.
MR. ENGLISH: That's all I have. Thank you.
THE COURT: Further questions?

CROSS-EXAMINATION

BY MR. MILTNER:
Q. Good afternoon, Mr. Hanson.
A. Good afternoon.
Q. Ryan Miltner representing Select Milk Producers.
I wanted to ask some questions about Foremost's plants that are mentioned your statement.
A. Sure.

Q. Your three Italian cheese plants --
A. Yes.
Q. -- do any of those plants have the ability to transition and produce cheddar cheese?
A. No, none of them do.
Q. Does Foremost dry the whey that is produced from those Italian cheese plants?
A. We dry some of the whey, and other -- some -- the other we sell in liquid form.
Q. The whey that is dried, is that done at those same facilities or is it moved to a different location?
A. It's -- one facility dries its own; then another -- there's another drying facility where whey solids are transported to.
Q. The whey that is dried then, is it -- are the sales of that whey reported to the NDPSR?
A. I believe the whey -- the dry sweet whey itself is reported.
Q. For your two cheddar plants -- and I may have asked this the last time you were on the stand, and I don't remember.
A. That's okay.
Q. -- do they produce blocks?
A. Yeah. One plant produces 640s, and the other plant produces 40s.
Q. Do either of them produce barrels?
A. Neither produce barrels.
Q. Is the whey from those plants dried at all by

Foremost?
A. Yes, but not at those facilities.
Q. And would that whey, once it's dried, would the sales be reported to NDPSR?
A. No, they wouldn't be in -- they are not in sweet whey form.
Q. Did Foremost Farms report plant processing costs for Dr. Stephenson's study that was conducted on or around 2019?
A. No.
Q. Did it report any plant processing costs for the updated study in 2022?
A. Yes.
Q. When it did report to the second study, did it report for cheese or whey or both?
A. Cheese -- cheddar cheese and whey.
Q. Did it report the cheddar cheese from both your 40-pound processing plant and your 640-pound processing plant?
A. I believe it was just the 40-pound plant.
Q. When it report -- when you reported the whey, did it -- did you have to pull costs from both the plant at which the whey was produced as well as the plant that dried the whey?
A. I believe there was a cost to transport the whey to the facility. And the facility we reported, it was no longer in operation. It was closed in December of 2022.
Q. Okay. Do you still have facilities that dry whey?

A. At our Italian plants.
Q. Did that Italian plant report its costs to Dr. Stephenson's survey?
A. I don't believe so because it was an Italian plant.
Q. Was Foremost Farms part of National Milk's survey of plant processing costs?
A. Yes.
Q. A witness earlier today didn't know the answer as to whether -- whether his cooperative participated and how it was reported. Can you -- can you confirm that when National Milk did its survey, it only used the data from its own member survey and did not include Dr. Stephenson's data?
A. That's what I understand.
Q. Okay.
A. It was a survey of National Milk cooperatives in a task force group.
Q. Do you recall if when that National Milk survey was completed, if the members of the task force or committee or survey group, whatever we are calling it, if they received a summary of those costs that said something along the lines of the average cheddar cheese make cost is X cents?
A. Yes, we received a summary but not the detail.
Q. How then, if you recall, did the committee take the summary number and arrive at the number that is now included in Proposal 7?

A. Well, these numbers, as from what I understand, were very close to what the average of that survey was. And, you know, the discussions we had was it was not just about the number. We know that this probably underrepresents what the true cost is. We -- we -- Foremost met with our board to get their perspective on it, and we agreed that we do want to increase Make Allowances to represent higher make costs, but we do not want to be disruptive to the market. And this was that fair compromise of the set of numbers that National Milk arrived at.

Q. And I think you said it was -- the number that was arrived at for Proposal 7 was close to the average of the survey number?

A. I believe so.

Q. Okay. So that would mean that there are some plants with higher costs than what National Milk has proposed and some with lower, correct?

A. Yes.

Q. And that's your recollection as to how that was arrived at?

A. Yes.

Q. Okay.

MR. MILTNER: Thank you very much.

THE WITNESS: Thank you.

THE COURT: Anyone else have questions that's not AMS?

AMS.

CROSS-EXAMINATION

BY MS. TAYLOR:

Q. Good afternoon.

A. Good afternoon.

Q. Let's see, where do I want to start. Well, first, I don't think this is kind of covered in your statement, but I'll ask of your Foremost plants. Have you all done -- invested in things to help you be more efficient? Whether it's on the cost side or increasing your yields, have you done that since the Make Allowances were last updated?

A. We have made some changes. A lot of our investment is in maintenance of the plants to make sure that we can successfully operate them. But we have made investments in tracking solids going through the plant to make sure that we're capturing all that data, to make sure that we're using the solids as best we can. We have invested a -- not in the cheese operations, but we invested in a greenfield milk separation plant in Greenville, Michigan. And that was back in 2018.

Q. '18 --

A. Yes.

Q. -- did you say?

A. Uh-huh.

Q. You mentioned to Mr. Miltner that Foremost did participate in the 2022 survey from Dr. Stephenson?

A. That's correct.

Q. So we'll be discussing that next week, I'm sure.

And the numbers that came out of that, do you find that those averages are representative of Foremost's costs?

A. I believe so. I mean, we have no reason not to believe that. We provided the data and went through that model's formula, and then we got the numbers back. So we weren't surprised relative to some of the other benchmarks that we saw.

Q. Okay. You -- in your statement you say that the Make Allowances that NMPF have proposed "strike a fair balance between the reduction in the producer pay price and reduction in the processor milk costs resulting from the increasing Make Allowance."

I just wanted you to expand a little bit on what you consider a fair balance.

A. Right. Well, when we looked at what was going to be the impact to the class prices with the National Milk Make Allowance changes, they were going to have an -- they will -- they would have an impact of around $0.50 to $0.60 per hundredweight, both on Class III and IV. If you looked at some of the -- if you look at the higher levels where IDFA is at, it has more of an impact, about $1.50 per hundredweight.

And in talking with our board, talking with our members, we just -- we felt that that impact was too great to -- to impose on dairy producers at one time.

Q. Okay. And so -- well, I'll get into this in a minute, I guess. That leads me to the question.

I wanted to talk a little bit about the basis discussion you have on the top of page 3. And that's -- another word we can think of it as a premium, I guess, but plus or minus, acknowledging it is not always positive, for sure.
A. Exactly. Uh-huh.
Q. Are these premiums -- how are they determined? Are they negotiated between Foremost and -- and I'm assuming since you are talking about it, that Foremost has some kind of process in place to negotiate this basis.
A. Yeah, I have a team that works for me, and their job is to market milk. And so they are going out, developing those relationships with customers, both on a contract basis, annual or multiyear, and then also on a spot basis, to -- to -- just making sure that we have long-term and short-term market access to our milk.
Q. And you talk about how those can -- those are not set in stone, right? They can fluctuate.
A. Yes.
Q. And so I wanted to talk a little bit about how that is impacting your producer pay prices already, because, you know, generally when I read this statement, the sentiment I walk away with is it's -- obviously it's impacting the producers already, whether it's through less premiums, you know, reblends, etcetera, and I just wanted to see if you could talk a little bit about Foremost and how at the producer level these increased manufacturing costs are impacting the milk check that they receive from

Foremost.
A. Whether it's from our customers or whether it's us internally, our higher costs, you know, have to get reflected back to the dairy producer for our customers to remain financially viable, for us to remain financially viable. So that -- yes, that has resulted in lower premiums pay paid to producers, with the higher manufacturing costs.
Q. Okay. And if under NMPF's proposed makes, which aren't -- you know, they are not a -- they are a compromise, I guess that's the word I'll use --
A. Sure.
Q. -- a middle ground, as you see it, would you say you would expect the reblending or the deducts, whatever you want to term, to be less? I mean, there would be some impact to the -- some positive impact to the producer milk check in that way?
A. That's what I would expect.
Q. I guess what I'm trying to ask as well is if you -- I mean, what I'm hearing is the numbers might change, but will the overall impact change? Does that make sense? You know, you have to pay it out of one side or the other, so are we netting anything positive?
A. I think there's a lot of value just to get the truth in the numbers, to making sure that the formulas are really acc- -- like really reflecting what's happening in the marketplace. Otherwise, there's a lot of confusion. There's a lot of angst out there, because if you have

reblends that are negatively impacting members, they don't understand where those are coming from. If you can explain what's going on with the Make Allowances and why you have higher costs, I think it becomes easier to get acceptance of the -- what the formulas are and what they represent.
Q. Okay. And so that leads me to a thought I had at the end. And I think what you are saying then is you find a benefit to find -- having more of that reflected in the regulated minimum prices rather than somehow reflected in the market --
A. Yes.
Q. -- prices that you see?
A. Yeah. Because if we're going to use this as our benchmark for how we price in the marketplace, in my mind, it has to have -- resemble what reality is, so everybody's engaged and on board.
Q. Okay. Thank you.
A. Uh-huh.
Q. On the top of page 4 -- and I think this leads to kind of -- the discussion is kind of the same, but what I read from this, kind of the reality is -- and this is a discussion you write up of why we shouldn't increase Make Allowances too much, too fast, right? Don't shock the system, I think is what you are saying.
A. Right. Yep.
Q. And what I read from that, if I can summarize, you can tell me if I'm correct, is that if we would increase

the makes too high, it's going to result in either less milk production and less -- and/or less farm members, right, because people are going to go out of business?

A. Right.

Q. And eventually that will lead to higher prices, but that's --

A. You're correct.

Q. -- sticky and slow?

A. Exactly. That's exactly right.

Q. I'm looking through my list to make sure I have covered everything.

Does Foremost use any risk management tools to help navigate this volatile market?

A. Yes, we do, quite extensively.

Q. Would you like to expand on that?

A. Specific to Make Allowance or specific to --

Q. Well, you're up here now, so just generally.

A. Well, in general, we spend -- my team spends a lot of time trying to hedge the block-barrel spread because it has such an impact on us that we spend a lot of time, spend a lot of resources managing that. And that's why we're so emphatic about some -- why we think you need to have one price series to represent each of the main commodities, because when you have more than one, it's very disruptive to our earnings on a month-to-month, year-to-year perspective. And then we talked about the impact it has on dairy producers, too.

We spent a lot of time -- we -- we pass through most of our milk costs to the finished product, but there's a lot of nuances in there that can add up, especially on a mozzarella operation. So there's a lot of protein and butter hedging that we spend a lot of time on, and then a lot of customer hedging that we're working with our customers, if they want fixed pricing, we can put positions on for them.

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

THE WITNESS: Okay. Thank you.

THE COURT: Anyone else?

Redirect?

MS. HANCOCK: Your Honor, that's all we have at this time. We would move to offer 154 as an exhibit.

THE COURT: Exhibit 154 is entered into the record.

(Thereafter, Exhibit Number 154 was received into evidence.)

THE COURT: Thank you. You may step down.

MS. HANCOCK: Your Honor, at this time we would call Mr. Rob Vandenheuvel.

THE COURT: Off the record.

(Whereupon, a break was taken.)

THE COURT: Unless you want, I can swear the witness in again.

ROB VANDENHEUVEL,

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

THE COURT: Your witness.

DIRECT EXAMINATION
BY MS. HANCOCK:
Q. Good afternoon, Mr. Vandenheuvel. Welcome back to the stand.
This time you understand that you are here to talk about Make Allowances?
A. Yes.
Q. And did you prepare a written statement --
A. Yes.
Q. -- to testify today?
A. Yes.
Q. Is that what we have marked as Exhibit NMPF-18?
A. Yes.
MS. HANCOCK: And, your Honor, if we could mark this as the next exhibit number?
THE COURT: I have 155. So marked.
(Thereafter, Exhibit Number 155 was marked for identification.)
BY MS. HANCOCK:
Q. And, Mr. Vandenheuvel, do you have three exhibits that are attached to your testimony that we have now marked as Exhibit 155?
A. Yes.
Q. And the first one is NMPF-18A.
A. Yes.
Q. And that's titled CDFA Manufacturing Cost Annual Data for California 2016 Data?
A. Correct.

MS. HANCOCK: Your Honor, if we could mark that for identification purposes as Exhibit 156?
THE COURT: Yes. So marked.
(Thereafter, Exhibit Number 156 was marked for identification.)
MS. HANCOCK: Thank you, your Honor.
BY MS. HANCOCK:
Q. And, Mr. Vandenheuvel, did you also have Exhibit NMPF-18B attached to your testimony, this one dated September 18th, 2007, on CDFA letterhead?
A. Yes.
MS. HANCOCK: Your Honor, if we would mark this as Exhibit 157?
THE COURT: So marked.
(Thereafter, Exhibit Number 157 was marked for identification.)
BY MS. HANCOCK:
Q. And then third we have what has been identified as Exhibit NMPF-18C, and it's titled Cost of Processing in Cheese, Whey, Butter, and Nonfat Dry Milk Plants?
A. Yes.
MS. HANCOCK: And, your Honor, if we would mark that as Exhibit 158?
THE COURT: So marked.
(Thereafter, Exhibit Number 158 was marked for identification.)
MS. HANCOCK: Thank you.
BY MS. HANCOCK:

Q. Mr. Vandenheuvel, would you mind proceeding with your testimony today?
A. Sure. For the sake of efficiency, I'll skip the introductory paragraphs, and as I go through the written testimony, I'll also skip over paragraphs that are largely repeated testimony from other National Milk witnesses.
The issue establishing appropriate Make Allowances here -- or manufacturing cost allowances, hereafter Make Allowances, in the Federal Order formulas is of critical importance to CDI, as we view this issue not only through the lens of a marketing cooperative co-owned by 258 member-owners, but also as a partnership of those same member-owners in making large-scale investments in dairy product manufacturing.
Unlike some of the other issues being considered by USDA in this hearing proceeding, there is overwhelming recognition across the industry by both producer and processor representatives that Make Allowances are in need of an update. Few businesses, regardless of industry, can say their fundamental economics are unchanged in the more than 15 years that have passed since the last update.
It's also important to keep in mind the broader picture, especially in a hearing like this, where we will delve into the minutia of the Federal Order formulas. Federal Orders utilize end product pricing formulas which calculate a minimum price for milk purchased by pooled milk handlers based on the wholesale price of four end products, specifically butter, nonfat dry milk, cheddar

cheese, and dry whey.

The Make Allowances that are part of these formulas are intended to generally represent the cost of converting raw milk into those end products. Simply put, the cost structure associated with converting raw milk into those four end products is different today than it was in the mid-2000s when the Make Allowances were last evaluated. An update is clearly warranted.

Specifically, Proposal Number 7 would adjust the Make Allowances used in all four classified milk pricing formulas. And the levels there noted are consistent with previous testimony and the proposal.

I'll skip over the next paragraph that references the mandatory reporting, which has been fully vetted in earlier testimony.

And risk of inaction:

While CDI joins National Milk in proposing long-term improvements to this process through better data, the immediate adjustments reflected in Proposal Number 7 in this hearing process are also a critical need for the industry. The risk of inaction or delayed action is simply too great to put the issue off any further.

Cooperatives are most exposed to financial risk of inaction:

Market-wide balancing is primarily conducted by farmer-owned cooperatives that have built milk manufacturing plants that produce storable dairy products like butter and nonfat dry milk. While non-cooperative manufacturers that purchase their raw milk from cooperatives as needed can scale milk purchases to their profitable demand for various end products, cooperatives, in their role as milk balancers, receive the residual volumes of milk and turn it into storable products.

CDI, like many of our fellow cooperatives, is on the front lines of this market dynamic, experiencing significant swings in milk processing volumes as we balance the seasonal ebbs and flows of our member-owners' milk production, as well as the ebbs and flows of seasonal demand for raw milk.

In 2022, the six CDI-owned manufacturing facilities processed as much as 31.8 million pounds per day in April of 2022, and as little as 24.6 million pounds per day in October of 2022, a swing of 7.2 million pounds per day, or 23% from the peak to the valley.

Managing that level of volume volatility is challenging enough. Doing so with an artificially elevated Federal Order Class IV price due to outdated Make Allowances magnifies the difficulty and increases costs borne by our member-owners.

Inaction creates winners and losers:

When the Make Allowance is set too low, a scenario that is playing out right now, the system creates winners and losers within the dairy farmer community. The losers are those producers who have made an investment in manufacturing infrastructure, either individually or through a cooperative, as their return on that investment is diminished or completely eliminated due to a milk price formula that essentially overvalues the raw milk being processed.

The winners are those producers simply selling milk to a third-party processor that is pooling milk on a Federal Order. Those producers are guaranteed an artificially-inflated Federal Order blend price and yet are contributing nothing to the financial stress the system is placing on the producers who have made investments in processing.

In essence, failure to maintain a Make Allowance that fairly represents current manufacturing costs creates a disincentive to invest in processing infrastructure for use in balancing supply and demand, which will ultimately create disorderly conditions if or when producers are unwilling to or unable to take on that cost.

Risk of over correction:

While an update to Make Allowances is warranted, CDI recognizes that there's also a risk to overcorrection. There are certain unknowns due to limitations in the available manufacturing cost data sources, such as the range of costs that may be seen if all plants making eligible products were required to report plant costs to USDA as opposed to the voluntary data sources we have today.

Another limitation is product yields using current technology; another limitation is benefits of automation; and finally, energy efficiencies or other improvements to plant efficiencies.

While CDI supports mandatory cost reporting that could provide reliable data in these key areas -- key issue areas, we believe that for the purposes of this hearing, the absence of available reliable data provides a justification for a more tempered adjustment in the very near term, which is what Proposal Number 7 represents.

Furthermore, the impact on dairy farms and on the regulated monthly milk price must be considered when evaluating these adjustments. It is simple arithmetic that an increase in Make Allowance will generate a lower resulting classified milk price. While a regulated milk price reduction due to higher manufacturing costs can be justified, the impact on dairy farms from a sudden and large milk check adjustment is a consideration that supports a more tempered approach.

The balanced approach:

Proposal Number 7 takes a balanced approach making incremental change to the current Make Allowances while erring on the side of conservatism. The proposal garnered unanimous support from the National Milk Board of Directors across cooperatives with and without significant ownership in processing assets.

The following are considerations that CDI made in supporting Proposal Number 7, particularly with -- particularly with respect to the adjustment in butter and nonfat dry milk Make Allowances.

CDI has experienced significant cost inflation across our network of manufacturing facilities since 2007 when the manufacturing cost allowances were last updated.

While CDI supports mandatory cost reporting to USDA as previously referenced, CDI participated in a statewide and mandatory cost study for dairy manufacturing plants when California operated under a state marketing order prior to 2018. This mandatory audited cost study was conducted by California Department of Food and Agriculture, or CDFA. The most recent publication from the results from that annual cost study reported results using 2016 data. And while I have a summary below, that was Attachment A of my testimony.

Also attached to this testimony are the results from CDFA's 2006 cost study, which is Attachment B referenced earlier, and also summarized in the table below. That 2006 cost study was specifically used, in part, as a basis for establishing the current Make Allowances in 2008.

So Table 1 has the breakdown. One area I would note is the next paragraph: As evidenced by the data in Table 1, the cost of producing butter and nonfat dry milk at California manufacturing plants surveyed by CDFA rose across all cost categories in that 11-year timeframe. The category processing labor saw some of the most significant inflation, a rise of 51.4% for butter and 48.6% for nonfat dry milk, an interesting finding in a cost area that one would expect to see some benefit of automation during that 11-year window of time.

The University of Wisconsin report:

In December 2021, Dr. Mark Stephenson, director of dairy policy analysis at the University of Wisconsin Madison, published a report in entitled Cost of Processing in Cheese, Whey, Butter and Nonfat Dry Milk Plants. And that is Attachment C referenced earlier.

This report requested and funded by USDA was based on feedback from 57 dairy manufacturing plants making either butter, nonfat dry milk, cheddar cheese, and/or dry whey. Included in the report was feedback from 12 butter and 27 nonfat dry milk plants that had fully completed the survey.

Specific to Dr. Stephenson's findings on the plant cost for butter and nonfat dry milk, the report found a weighted average processing cost for all respondents of $0.1411 per pound for butter and $0.2933 cents per pound for nonfat dry milk.

Upon review of the report's findings, CDI grew concerned about the widely divergent findings for the cost of manufacturing butter and nonfat dry milk, especially when compared to other plant cost results published previously by Dr. Stephenson.

We questioned the method used to allocate costs among the various products being produced in a single facility and whether those methods contributed to the significant divergence in the reported cost of manufacturing.

Unable to reconcile precisely what caused the difference, we evaluated the butter and nonfat dry milk results in total, rather than individually. Below are the results of that evaluation.

And what I show here in this table is the reported butter processing cost on a weighted-average basis and the reported nonfat dry milk processing cost on a weighted average basis, and that 14 -- .1411 -- or $0.1411 per pound weight average as referenced earlier for butter and $0.2933 cents per pound for nonfat dry milk.

I then multiplied that cost per pound by 3.5 pounds of butterfat and a yield of 1.211 pounds of butter per pound of butterfat to get 4.2385 pounds of butter from a hundred pounds of milk at 3.5% butterfat and 8.685% solids nonfat.

And then I did the same calculation, 8.685 pounds of nonfat dry milk -- I'm sorry -- 8.685 pounds of solids nonfat times a yield of 0.99, gives a result of 8.5982 pounds of nonfat dry milk for every 100 pounds of milk at those stated components.

I multiplied the cost from the University of Wisconsin report in the second column by the number of pounds identified in the third column to get the total cost per 100 pounds of milk.

And then summed those to get $3.1198 per hundredweight combined, and divided that by the total number of product pounds, which would be the 4.2385 pounds of butter and the 8.5982 pounds of solids -- of nonfat dry milk, to get a weighted average cost per pound of butter and nonfat dry milk of $0.243 per pound.

We then compared the weighted average cost of $0.243 per pound to the current Make Allowances of $0.1715 per pound for butter and $0.1678 per pound of nonfat dry milk.

Under that comparison, the proposed updated Make Allowance of $0.21 per pound for both butter and nonfat dry milk included in Proposal Number 7 represents the capture of 50% of the difference between the current Make Allowances and weighted average cost per pound of butter and nonfat dry milk as calculated above, rounded to the nearest penny per pound.

Given the intent of Proposal Number 7 to err on the side of conservatism and be reviewed once again at a later date with the availability of data from a mandatory audited reporting of plant costs and yields, it seemed very reasonable to propose an updated allowance equal to approximately 50% of the difference between the current Make Allowances and the updated weighted average manufacturing costs as calculated in Dr. Stephenson's USDA commissioned and funded cost study.

This was further validated by the California specific data from CDFA in 2016 that demonstrated, even at that point, seven years ago, the real cost of producing better and nonfat dry milk in California was already around $0.20 per pound.

Weighing all the available information, and in the context of the broader goal to provide USDA with the authority to collect mandatory cost data in advance of the next Make Allowance adjustment, CDI joins National Milk in supporting Proposal Number 7, a balanced adjustment to Make Allowances that, again, garnered the unanimous support of the National Milk Board of Directors.

That concludes my written testimony.

Q. Thank you, Mr. Vandenheuvel.

MS. HANCOCK: Your Honor, we would make him available for cross-examination.

THE COURT: Cross other than AMS?

CROSS-EXAMINATION

BY MR. ROSENBAUM:

Q. Steve Rosenbaum for the International Dairy Foods Association.

If we turn to page 4 of your testimony, which is Exhibit 155, you have a table that reports as to what the what the California Department of Food and Agriculture cost studies had shown to be the costs of making butter and nonfat dry milk in 2006 and 2016, correct?

A. Correct.

Q. And what this study showed for nonfat dry milk was that the cost of making that product in 2016 was $0.2082 correct?

A. Correct.

Q. And -- and to state the obvious, we are in 2023 today, correct?

A. Correct.

Q. And it is National Milk Producers Federation's

proposal that the Make Allowance be set in the Federal Order system, in 2023, or whenever the actual decision comes out, at $0.21, correct?
A. Correct.
Q. So you -- your -- which is really a rounding, if you will, of what the cost to manufacture was deemed to be for nonfat dry milk seven years ago in 2016, correct?
A. Correct.
Q. And it is certainly -- and by the way, this document shows that between 20016 and two thousand -- let me start that again.
This document shows that between 2006 and 2016, the cost of making nonfat dry milk had increased by 25.1%, correct?
A. Correct.
Q. And -- and certainly you would agree with me that the actual costs have gone up substantially since 2016, correct?
A. They have definitely increased since 2016. I would -- I would note that these are California-specific numbers, which -- and California certainly has some of its own dynamics around manufacturing costs, which would be a limitation of this dataset.
Q. You're aware, though, the federal government has relied upon the CDFA data in the past in setting Make Allowances, correct? Not as the sole source of information, but as part of the source of information, correct?

A. In my review of the documentation from the last Make Allowance reset, I believe they applied -- USDA applied the California product volumes to the CDFA data and the non-California volumes to another dataset.
Q. Okay. So when you then sort of describe what the National Milk proposal would do, and I think you laid out pretty plainly at the bottom of page 5 and the top of page 6, that your proposal would only attempt to capture 15 -- 50% of the actual increase in cost of manufacture since Make Allowances were set back in 2008; is that correct?
A. 50% of the difference between the current Make Allowance and this interpretation of Dr. Stephenson's numbers from his 2021 report.
Q. Are you aware that his 2021 report was based primarily upon 2018 data, with a few entries from 2019?
A. I don't know the exact timing of when all those entries were made, but they were as early as 2018, yes.
Q. Okay. So it's more accurate, isn't it, to state that Proposal 7 would represent the capture of 50% of the increase in cost of manufacture between 2008 and 2018?
A. That would be -- that would be an accurate statement with the caveat of the items noted on page 3, which is the limitations of the available data, not having the confidence that all plants making eligible products required to report costs, not having updated information on product yields, which Dr. Stephenson's analysis does not include a yields update, and then any other

efficiencies that might not be captured. So with that caveat, I would agree with your statement.
Q. And you are aware that -- that Dr. Stephenson conducted cost of manufacture reports in 2006 and 2007, which were then relied upon by USDA to set Make Allowances along with the California Department of Food and Agriculture data?
A. I'm aware from reading the material that that's the case.
Q. And are you aware that the general methodology Dr. Stephenson engaged in to conduct his reports remained the same, with the exception of the problem you identified on page 5 about how properly to allocate certain costs between butter and nonfat dry milk?
A. I'm aware that the -- most of the methodology did remain the same. There was a distinct difference in the length of time from the previous reset of the Make Allowance. That was about a seven- or eight-year gap, and we have got about double that. But, yes, I'm aware the methodology has been consistent.
Q. I'm sorry, is --
A. Has been consistent.
Q. Thank you.
Now, I assume you would agree costs have increased since 2018?
A. They have definitely increased since 2018.
Q. By that, I mean the cost of making butter and nonfat dry milk, correct?

A. My guess is the cost of making almost anything, but, yes, butter and nonfat dry milk.
Q. Okay. Now, you do know, I'm sure, that Dr. Stephenson has produced a more recent report than the one that you had marked as Hearing Exhibit 158, correct?
A. Yes. At the time of preparing this testimony, I didn't have that information available. I also felt it was most appropriate to rely on an analysis that had been commissioned by USDA as part of this proceeding.
Q. Have you had a chance to read the more recent report?
A. I have had a chance to review some of the numbers. I would not claim to be an expert in all the in and outs of it.
Q. Okay. Do you -- have you at least concluded that the problem that you identified on page 5 relating to Dr. Stephenson having used, I will call it a non-traditional method of allocating costs between butter and nonfat dry milk, have you determined that in the more recent report, which is yet to be -- which is IDFA Exhibit 1, that -- not yet introduced into evidence -- that he has reverted to the traditional method of allocation?
A. That -- that does make it easier to make a comparison to historic numbers. I did -- I did notice that.
Q. Okay. Now, you say on page 3 that, quote, "failure to maintain a Make Allowance that fairly

represents current manufacturing costs creates a disincentive to invest in processing infrastructure for use in balancing milk supply and demand, which will ultimately create significant disorderly conditions if or when producers are unwilling or unable to take on that cost," end quote.
Do you see that?
A. Yes.
Q. But you are not, in fact, proposing a Make Allowance that would, quote, "fairly represent current manufacturing costs"; isn't that fair?
A. I don't believe there's going to be testimony entered into the record at this hearing that can fairly represent to the penny current manufacturing costs because of some of the limitations. So what I have proposed as a justification for National Milk's Proposal 7 is using the available data, but putting conservatism into that because of the lack of data.
Q. But -- but you have agreed -- you have agreed, I believe, that insofar as Dr. Stephenson's reports are concerned, the methodology he has used in his most recent report is fundamentally consistent with the methodology that he used in the earlier reports that USDA found sufficiently reliable to utilize in its setting of Make Allowances; is that right?
A. Yes. In terms of his methodology, that methodology has not resulted in the past in USDA using that data exclusively in setting Make Allowances. But, in

part, just as I have done here in this justification.
Q. Okay. But the end result is your numbers only get halfway to what Dr. Stephenson said in his 2021 report were the 2018 -- or 2019 data weighted average cost to manufacture; is that right?
A. The use of that 50% to account for the data lacking is -- is a correct observation.
Q. And the National Milk proposal would, if you will, leave processors high and dry with only 50% of the cost increase as of 2018 having been accounted for by higher Make Allowances, unless and until there was some other milk order hearing to do something to change that; is that right?
A. I think it's important not to evaluate a proposal against perfection but to evaluate it against where we are today. This represents, in our opinion, in CDI's opinion, as a significant manufacturer in the United States, as a significant improvement in the minimum price formulas, while still balancing the limitations of data, the impact on producers, and all the other things in my testimony.
Q. Okay. I recognize you, I presume -- well, I don't know. Did you participate in Federal Order issues prior to California joining the Federal Order system?
A. I did not.
Q. Okay. Do you know whether USDA has ever -- since the product pricing formula approach to setting minimum prices came in effect in 2000 -- has ever failed to adopt Make Allowances that it viewed as reflecting the weighted

average cost of manufacture 100%?
A. I'm not -- not aware of a response to -- to that particular question in the way you framed it. But I will observe that if it was a simple plug and play, this cost data, put it into the formula, these hearings would be a lot shorter. And so there's a lot of different perspectives that need to be put into the record, looking at different angles beyond just the numbers on a singular report.
Q. And just so the record is clear, you are aware that we -- that Dr. Schiek has performed certain analysis using the most recently available California Department of Food and Agriculture data as well and that that also forms part of the IDFA proposal?
A. I'm aware of some of the work. Look forward to hearing his testimony.
Q. Okay.
MR. ROSENBAUM: That's all I have.
THE COURT: Ms. Hancock.
MS. HANCOCK: Your Honor, I see that we're at 5:00. Mr. Vandenheuvel will be available here tomorrow. I thought now would be a good time to talk about the line-up for tomorrow as well.
THE COURT: I think so unless -- I see no objections. Yes, thank you.
Are you the keeper of the lineup?
MS. HANCOCK: Well, for this part of the hearing, while we're still putting on our witnesses, I am, your

Honor.

And anybody can shout out if you think that what I have is wrong, but we will complete Mr. Vandenheuvel's testimony tomorrow morning. We will move on to Paul Bauer -- maybe not in this order, but this is the list of witnesses -- Paul Bauer, Monty Schilter, Mike John. And I believe we're only going until 11 o'clock, at which time we'll take an early lunch to get back by noon to do the dairy farmers.

MS. TAYLOR: That is correct. We'll start virtual dairy farmer testimony at noon. We have seven signed up to testify tomorrow, so I imagine that will take us again to around 1:30-ish, and maybe we can take a break and use up the last hour of our day, and then finish at 3:00.

THE COURT: Anyone else have anything to contribute? That sounds good to me. Thank you for the organization on this.

MS. TAYLOR: Does anyone else have someone that needs to testify tomorrow?

MR. ROSENBAUM: I think our expectation is that we will use up tomorrow with the witnesses that National Milk has, your Honor. And I don't think -- if it turns out we have, you know, 45 minutes extra, I think it would not make sense to try to -- frankly, our witnesses are at this point scheduled to come in next week.

THE COURT: Ms. Hancock, you look like you might have had something to say.

MS. HANCOCK: Nope.

THE COURT: Back on the record.

Off the record there was a little further discussion, and it was suggested that the line-up of witnesses that we discussed earlier on the record would probably take us through the whole day tomorrow, Friday. And then -- so we won't -- we won't have any witnesses in the batter's box, so to speak, and in the on-deck circle for the purposes of that day. If we have a little bit left over, that would be fine. I concur with all of that.

And unless anyone else has anything, it's 5:02, let's adjourn for the day. See everyone back here at 8:00 a.m., just like usual.

(Whereupon, the proceedings concluded.)

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STATE OF CALIFORNIA)
) ss
COUNTY OF FRESNO)

I, MYRA A. PISH, Certified Shorthand Reporter, do hereby certify that the foregoing pages comprise a full, true and correct transcript of my shorthand notes, and a full, true and correct statement of the proceedings held at the time and place heretofore stated.

DATED: October 1, 2023
FRESNO, CALIFORNIA

MYRA A. PISH, RPR CSR
Certificate No. 11613

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