CERTIFIED TRANSCRIPT

NATIONAL FEDERAL MILK MARKETING ORDER

PRICING FORMULA HEARING

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

Before the Honorable Jill Clifton, Judge

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Carmel, Indiana

September 25, 2023

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Reported by:

MYRA A. PISH, RPR, C.S.R.
Certificate No. 11613

A P P E A R A N C E S:

FOR THE USDA ORDER FORMULATION AND ENFORCEMENT DIVISION, USDA-AMS DAIRY PROGRAM:

Erin Taylor
Todd Wilson
Brian Hill
Michelle McMurtray

FOR THE AMERICAN FARM BUREAU FEDERATION:

Roger Cryan

FOR THE MILK INNOVATION GROUP:

Ashley Vulin
Charles "Chip" English

FOR THE NATIONAL MILK PRODUCERS FEDERATION:

Nicole Hancock
Brad Prowant

FOR SELECT MILK PRODUCERS, INC.:

Ryan Miltner

FOR EDGE DAIRY COOPERATIVES:

Dr. Marin Bozic

FOR LAMERS DAIRY:

Mark Lamers

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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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M A S T E R I N D E X

SESSIONS

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M A S T E R I N D E X

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M A S T E R I N D E X

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MONDAY, SEPTEMBER 25, 2023 - - MORNING SESSION

THE COURT: On the record. We're back on record resuming this milk rulemaking hearing on September 25, 2023. It's approximately 8:01 a.m. We're in Carmel, Indiana, and my name is Jill Clifton.

More about why I am here after we do some other preliminary matters.

I would invite someone from the Agricultural Marketing Service to put on the record what we anticipate for today and basically where we are in the hearing.

MS. TAYLOR: Good morning, your Honor. This is Erin Taylor with AMS.

I think on today's agenda we'll start with National Milk witnesses, and here are -- in the room will be Craig Alexander, Chris Hoeger, and Cal Covington. And then if we have time, we could put on Mr. -- Dr. Schiek from the Dairy Institute of California. And there may be time at the end of the day where we'll be able to get someone else on, but I think that will take up a good portion of the day.

THE COURT: And what time would you anticipate we would leave this room?

MS. TAYLOR: Typically we go until 5:00. We have been breaking from noon to 1:00-ish -- 12:00-ish to 1:00-ish for an hour for lunch. We do try to take two breaks in the morning, and two in the afternoon, short breaks, to give the court reporter a rest.

THE COURT: And all the other participants. She's more durable than everyone else.

MS. TAYLOR: She's the most important person besides yourself in this room, so I want to make sure she's with us.

THE COURT: Well, I'm delighted to be here.

Channing Strother, our USDA Chief Judge, is very disappointed that he is not here. He felt fine Thursday, played golf. On Friday, he didn't feel so well.

So Friday afternoon, after he had been with a sore throat and very non-energetic, very not typical at all, he tested, and he showed up positive for COVID. So he knew he should not come, and invited me to step in. And I was delighted, so here I am.

I will just wait to see whether he wants me to continue on until this hearing ends or whether my role will end this week. A lot will depend, I think, on whether the government funding lapses. Because if the government funding lapses, I don't know what happens with the rest of the hearing. So we'll just stay tuned on that.

All right. What other preliminary matters?

Mr. English, would you take the floor, identify yourself, and just state what you revealed to me and AMS before we went on record.

MR. ENGLISH: Good morning. It's great to see you, Judge Clifton. My name is Chip English for the Milk Innovation Group.

Mr. Rosenbaum, for the International Dairy Foods

Association, is celebrating Yom Kippur and, therefore, is not available today until sunset. But we are -- you know, we are here for the Milk Innovation Group to do the best we can, especially since the issues today are Class I, to protect the interests of both the Milk Innovation Group and the International Dairy Foods Association.

THE COURT: Thank you. And I'm very mindful that it is Yom Kippur, the holiest day of the year for much of the population of the world, and it's a solemn day of fasting, atonements, and so on. So I -- I'm mindful of that. We will do anything we can to accommodate those who are observant of that holy day today.

All right. The only other thing that I think I must note as to where we are in the history is we are very near Indianapolis, and the Indianapolis Colts won a squeaker yesterday and are to be congratulated.

MS. TAYLOR: Boo. Booing on the record.

THE COURT: All right. What other preliminary matters need to be put on the record before the witness who is in the stand begins to testify?

MS. HANCOCK: Is it okay to proceed with the witness?

THE COURT: Yes, you may. So first I'd like you to state and spell your name for the record.

THE WITNESS: My name is Craig, C-R-A-I-G, Alexander, A-L-E-X-A-N-D-E-R.

THE COURT: And have you previously testified in this proceeding?

THE WITNESS: No, I have not.
THE COURT: All right. I'd like to swear you in at this time. You may remain seated.

CRAIG ALEXANDER,

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

THE COURT: Thank you.
You may proceed.

DIRECT EXAMINATION

BY MS. HANCOCK:
Q. Mr. Alexander, would you mind stating your address for the record as well?
A. My current business address is 700 Ellicott Street, E-L-L-I-C-O-T-T, Street, Batavia, New York, 14020.
Q. And I'm not -- I don't recall which exhibit number we're up to.
Mr. Alexander, did you prepare a written statement identified as Exhibit NMPF-31?
A. Yes.
MS. HANCOCK: Your Honor, if we could mark that as Exhibit 245?
THE COURT: It shall be done.
(Exhibit Number 245 was marked for identification.)
MS. HANCOCK: Thank you.
BY MS. HANCOCK:
Q. Mr. Alexander, proceed with your statement, please.

A. Thank you.

Good morning. My name is Craig Alexander. My testimony today is provided on behalf of and in support of the National Milk Producers Federation (NMPF) Proposal 13 to restore the original Class I skim milk mover enacted under Order Reform in all Federal Milk Marketing Orders (FMMOs).

My testimony is provided on behalf of Upstate Niagara Cooperative, an NMPF member cooperative that supports the full package of NMPF proposals at this hearing.

Upstate Niagara Cooperative is headquartered in Lancaster, New York, and is owned by about 250 farmers including conventional and organic farms. The cooperative markets over 2.5 billion pounds of milk annually and operates eight processing plants, seven in New York and one in Pennsylvania.

The processed products include fluid packaged milk, cultured products, concentrated milk and cream, nonfat dry milk, butter, and retorted beverages. These products are sold to foodservice, retail, and institutional buyers across the nation and in Puerto Rico. We also market milk to several other bulk milk customers located in Western and Central New York, Western Pennsylvania, and Ohio. We market milk within Federal Order 1 and 33, as well as unregulated and state-regulated areas in New York and Pennsylvania.

I grew up on a small dairy farm in Central New

York and attended the State University of New York at Albany and Cornell University, where I received a master of science in agricultural economics with a focus on dairy markets. I have spent 40 years involved in a variety of professional capacities for Upstate Niagara Cooperative, Dairy Institute of California, Cornell University, and O-AT-KA Milk Products Cooperative. I currently serve as the senior director of planning and regulatory affairs for Upstate Niagara Cooperative. I have appeared in several state and Federal Milk Order hearings since the 1980's.

Background of the Current Class I Mover.

Pricing of farm milk for fluid drinking purposes has been a focal point in the industry since the infancy of commercial milk processing and distribution to stores and consumers. An imbalance of market position between farmers with a perishable product and fluid milk processors with variable demand saw the developing need to price milk differently for fluid needs versus milk used for manufacturing cheese, nonfat dry milk, butter, and other storable products.

While at first, producer cooperatives attempted to recognize this difference by pricing milk by use, the inherent bargaining disadvantages dairy farmers had in marketing milk saw the breakdown of the early forum of classified pricing. This was especially true as surpluses developed, sales declined, and the economy fell into the depression of the 1930s. As result, government action was necessitated and a variety of economic regulations, both at the state and federal levels, were implemented, with some involving classified pricing mechanisms to stabilize producer returns.

The modern form of this economic regulation now known as Federal Milk Marketing Orders (FMMO), was enacted in 1937 in the Agricultural Marketing Agreements Act (AMAA). It allowed for producers to propose and vote on regulations to set classified prices based on use and combine the proceeds such that producers supplying a market could equitably share the benefits of the higher value Class I fluid market, but also share the burden of the lower value class or classes.

Class I prices were set by a variety of means. In some markets, economic formulas were used, while in others, market-clearing manufactured product price indexes, plus some regulated fixed premium, was used.

At first, markets were relatively small and isolated to the areas around major cities. Over time, transporting milk supplies and distribution of finished fluid milk products became more feasible. The wider areas of competition between processors necessitated a more coordinated means to set Class I prices both over time and over geographic distance between different milk order areas.

The Minnesota-Wisconsin Monthly Milk Price Survey of unregulated Grade B milk came to be used instead of economic formulas and indexes in the 1960s, with Class I prices set using the previous month's survey price. This would essentially set the coming month's Class I price in advance. In this way, Class I processors would know their costs in advance and be able to announce prices to customers.

However, with being set monthly based on competitive pay prices, prices could move over time to represent milk values to producers. The supply and demand forces shaping milk markets could be reflected in a timely fashion. The MW price was a single price which blended the value of the Grade B milk used to manufacture butter, dry milk powder, and cheese products.

At the same time, Class I price differentials were added to the MW mover to recognize Grade A production costs, servicing of fluid markets, and geographic dispersion of location value, recognizing transportation costs between and within market areas. This provided price signals between areas of reserve milk supply to areas with greater Class I fluid needs.

Although not in lockstep with the MW each month, the higher Class I price and monthly movement provided a short-time lag and signaled incentives to supply Class I milk by allowing processors of Class I products advanced cost information. Thus, both the location value and the time value of price signals were combined with the valuation of milk through classified pricing and together were key components of the pricing system of Federal Order regulation.

While the MW price mover worked well for several decades, during the 1990s it became apparent that a shrinking Grade B milk supply and reduced number of plants buying the milk was leading USDA to have less confidence in the survey's statistical basis. For a short time, a modified version of the MW mover that was known as the basic formula price, or BFP, was used. The BFP operated in a similar fashion, moving Class I prices monthly based on a survey of results, along with product price changes, but suffered from the same declining Grade B milk volume.

I'm going to summarize a bit here what Dr. Vitaliano went over, but during the FMMO reform process, several alternatives to set and move Class I prices were reviewed. The transition to the new class price formulas involved the uniform adoption of four classes of milk, including two manufacturing use classes, Class III and Class IV. USDA had to then decide on a replacement to the MW BFP to set and move Class I prices.

In 1999, the Department determined that the mover should be the higher-of the Class III or Class IV price as calculated using the first two weeks of the prior month's price survey data.

During that reform process over a number of different areas of the reform, there was committees that looked at different aspects of the Federal Order system. One of those areas, obviously, was Class I price. And USDA laid out four criteria that they used in evaluating the mover. Dr. Vitaliano talked about that. And those those four factors were basically looking at the fact that given the separation of manufacturing milk into two classes, using the higher-of Class III or Class IV would assure that shifts in demand for any one manufactured product will not lower the Class I price.

Second, using the higher-of the two classes to move Class I prices would help to reduce the volatility in milk prices.

Third, a major consideration was to address class price inversions and depooling.

And fourth, and very important, was the -- the ability to -- or the -- to purpose to help incent movement to Class I buyers and thereby assist Class I processors in the competition for available raw farm supplies.

I'll reiterate a quote from that decision that speaks to the issue we have here today. And in that quote, "In some markets, the use of a simple or even weighted average of the various manufacturing values may inhibit the ability of Class I handlers to procure milk supplies in competition with those plants" --

Q. Mr. Alexander, just -- if you could just be mindful of your speed.

A. Slowing down. Yep, I will. Thank you.

-- "supplies in competition with those plants that make the higher-of valued of the manufactured products. Use of the higher-of the Class III or Class IV price will make it more difficult to draw milk away from the Class I uses for manufacturing."

For all these four reasons, it was included that the higher-of the Advanced Class III or Class IV skim milk value should be the mover for Class I prices. The higher-of mover fit within the precedence and norms of historical use of how Class I prices relate over different Federal Milk Marketing Orders over periods of time and between other class prices since the early '60s under the MW milk mover formula. This use of the higher-of mover for pricing Class I skim milk prevailed in all orders in the Federal Order system until the 2018 Farm Bill legislation.

Again, I'm just going to skip over some of that that Dr. Vitaliano discussed in terms of the history of implementation of the average-of mover, which was chosen and implemented in the 2018 legislation. But suffice to say that it was the intention of both Class I buyers and dairy farm sellers that the change would be revenue neutral over the long-term and would accommodate certain buyers' interest in using available price risk management tools.

However, due to the Congressional mandate, the USDA could not apply the four criteria as originally adopted when choosing the higher-of mover and as clearly articulated in the 1999 Final Decision of Federal Order Reform.

Unfortunately, untended consequences resulted as the 2018 amendment has not operated as intended or anticipated by NMPF or its producers. It has, instead, exacerbated disorderly marketing conditions and negatively impacted producer revenue. These serious and negative outcomes will continue so long as the average-of Class I mover remains in place.

Disorderly Conditions Caused By the Average-of Mover of Class I Prices.

The following problems were revealed by the change to the average-of mover and resulted in the erosion of producer confidence in the operation of the FMMO system as a consequence.

Number 1: Pricing of Class I milk was significantly reduced without recovery for producers in other class prices. Producers with higher Class I utilization were most severely impacted.

2: Due to increased price discrepancies and price inversions, depooling increased with inequitable impacts for handlers and producers, especially those who do not have options to depool, while others can avoid the pool when price inversions occur.

3: Class I prices meant to incent movement of milk to fluid processors relative to manufactured prices were disrupted more of the time under the average-of mover than occurred with the higher-of mover pricing.

4: The pricing discrepancies were not a one-time anomaly and, in fact, have caused and will continue to cause problems for orderly marketing -- markets in the future if not remedied and put back to a higher-of mover pricing.

Negative Producer Prices and Income Impacts.

Dr. Vitaliano discussed various aspects of the impacts of the average-of mover in terms of both the asymmetric risk of dairy producers. He well discussed and explained in great detail when prices spread between Class III and Class IV above $1.48 per hundredweight, then that can create a loss of income to producers. In essence, there's a $0.74 cap in terms of how high that Class I price can go, and so that creates a reduction in income to producers.

Chart 1 shows on a monthly basis the difference in price between the higher-of versus the average-of mover plus $0.74. So you can see from the chart that large differences and reductions during some months in the past few years.

Producers painfully saw the shortfall in milk checks using the average-of mover during 2020 with the large spread in prices between manufacturing classes. Class I skim milk prices under the average-of mover deviated by over $5 a hundredweight in December of 2020.

Obviously, this asymmetric price risk of the current average-of mover became particularly acute during the COVID-impacted markets driven by government policies and stimulating cheese consumption. However, negative impact on producers happened again throughout much of 2022 and 2023. This suggests that this is not a one-off pandemic-era issue.

During 2022 and 2023, Class IV prices have well exceeded Class III. When Class III and Class IV spreads widen, the average-of mover performs poorly compared to the higher-of mover.

National Milk Producers Federation Exhibit 30A details the calculation of losses by month and by Federal Order since the legislative average-of mover became effective in May 2019. The combined market losses on pooled Class I skim milk values in all orders has reached over 940 million pounds -- dollars through July 2023. In the Northeast, FMMO producers lost 178 million during that time. The largest loss across all Federal Milk Marketing Orders occurred in December 2020.

Another witness will discuss the serious impact on the Southeast market, where producers suffered larger per hundredweight negative returns as a result of the current average-of mover, as the region has higher Class I utilization and a strong demand for milk.

More recently, in 2022 and early 2023, we can see there are significant losses in 12 of the 19 months since January '22, resulting in a net loss of $264.9 million.

National Milk Producers Federation appreciated and supported Secretary Vilsack's partial compensation of these losses through the Pandemic Market Volatility Assistance Program. However, as stated by Dr. Vitaliano, this would not have been needed if the change to the Class I mover had not been made.

Even more importantly, producers cannot rely on USDA -- cannot rely on Congress, nor can we rely on taxpayers to always make up the difference due to pricing disparities caused by the average-of mover. This type of policy also does not make up for the loss of timely market signals needed during periods of strong demand and/or tight supply.

Negative Impacts From Increased Depooling.

Depooling of producer milk typically can happen where manufacturing class prices rise above the pooled returns generated by the different classes of use in the market pool. As described previously, this is not an efficient or equitable condition, and USDA sought to reduce this disorderly result as a rationale for the use of the higher-of mover during Order Reform.

The in and out of depooling milk was something the USDA tried to mitigate through the regulation of Class I price levels and relationships with other class prices. For example, USDA expressly chose to reduce the time lag in pricing information by using the two-week advance Class III and IV movers in the Federal Order Reform to help limit price inversions -- that's when Class I prices, being below one or more of the other classes -- and thereby reduce incentives to depool milk.

The change to the average-of mover significantly increased the level of disorderly marketing because Class I prices were lower relative to one of the other manufacturing classes. This created greater incentives to depool milk. This ultimately led to lower uniform prices for pooled milk, and the situation has recurred more frequently since the legislative change to the Class I mover was made.

This reality confirms the 1999 Final Decision justification that the higher-of mover would assure that shifts in demand for any one manufactured product will not lower Class I prices.

To reiterate and provide an example, there was enhanced demand for cheese generated by the Farmers to Families Food Box Program. The Program's significant purchases of cheese for food assistance relative to the demand for butter and nonfat dry milk led to the comparatively lower Class I prices. These class price inversions resulted in substantial depooling of Class III milk and disorderly marketing conditions during the second half of 2020. Other proponent witnesses will provide further information and discussion around the increased problem of depooling caused by the average-of mover.

However, the problems of 2020 are not a one-time phenomenon. Class price inversions recurred in 2022 and 2023. This time it featured higher Class II and Class IV prices compared to uniform market or blend prices. The result was substantial depooling of Class II and Class IV milk, while other milk was required to remain in the pool and disproportionately absorbed the impact of price inversion.

As an example, Table 1 shows Federal Order 33 pooled milk in Class II and Class IV during October 2021 and October 2022. October 2022 Class II and Class IV prices were $25.73 per hundredweight and $24.96 per hundredweight, respectively. With the lower announced uniform price of just -- that should be $22.99 -- $21.81 was actually the Class III price.

THE COURT: Let me interrupt you. Identify where in the document you just made a correction.

THE WITNESS: That was in the second paragraph, seventh line, I believe, in -- on page 7 of my written testimony.

THE COURT: All right. And tell me what used to be there and what it should be.

THE WITNESS: Okay. The uniform price should have been stated as $22.99. Instead, what was printed was $21.81, which was, in fact, the Class III price in that month.

THE COURT: Thank you. You may resume.

THE WITNESS: Thank you.

The announced Class I price was $24.71 with the average-of mover, and would have been $26.79 under the higher-of mover, $2.08 higher, and higher than both the Class II and Class IV milk price.

Table 1 simply shows the difference between October 2021 and October '22 in terms of pooled milk volumes and shows a substantial decline in October '22 of both those classes dramatically reduced to a third in October '22 versus '21 on Class II milk and almost nothing in terms of Class IV, 166 million pounds to 14.6 million pounds in 2022.

Pooling is a complicated phenomenon impacted by more than just one factor. However, a change in pricing which contributes to a lower relative Class I price to manufacturing prices, such as we have seen, can't help but reduce incentives to pool. The use of the average-of mover results in more depooling and increased potential for different price returns to producers within a market area. Ultimately, this undermines the FMMO goal of uniform returns to producers.

With the potential for greater discrepancies between producers and less milk pooled, there will be reduced incentives to supply Class I milk and increase potential for differences of raw milk cost to processors of like dairy products. Should the average-of mover continue to be used, it will be destructive to efficient operation of milk markets over the long run, as production, processing, and milk movement incentives will adjust accordingly.

Negative Impacts to Timing of Price Signals to Producers and Processors -- Or to Processors and Producers.

The generally higher prices for Class I milk act as a realtime signal for Class I processors to producers to draw more milk when needed to Class I use versus manufacturing uses and encourages farmers to produce more milk than needed. Under the higher-of mover, as there was with the BMW BFP mover, there is a short delay, although the higher-of mover is actually 18 days shorter than the MW BFP of market prices being transported -- transmitted to producers.

This does sometimes result in a variance or inversion as to how Class I prices relate to manufacturing prices. Typically these inversions resolve quickly as markets regain equilibrium. However, the change to the average-of mover exacerbates delays in price transmission to an even larger magnitude. Months go by where the prices not only do not catch up, but, in fact, never get caught up due to the maximum upside value being no greater than $0.74 per hundredweight for producers.

Using an averaging concept disconnects the Class I price from the competitive manufacturing prices, and there is no recovery of lost income for producers. This disconnect further disrupts the price signals by disincentivizing the movement of milk to Class I outlets where other options exist, as well as depooling already discussed.

Additionally, the larger and longer variance in the market signals reduces the incentive for farmers to produce and supply milk when the market needs it. Both characteristics of disrupted price signals are at odds with the purposes of the AMAA and FMMOs.

The AMAA speaks directly to correcting such problems inherent in fluid milk markets prone to disorderly marketing problems, not exacerbating them. Our witnesses, both producers and cooperative representatives, have or will further enumerate with additional testimony the significant cost and disruption to them.

Negative Impacts Are Likely to Recur.

The current Class I mover does not operate as intended because it builds in an unintended asymmetric risk to producer income, resulting in millions of dollars in losses of producer income. As we have seen, price volatility and periodic significant Class III and Class IV price discrepancies have been a basic feature of dairy markets in the recent past.

Since 2000, I have calculated the difference in Class III and Class IV prices when they have exceeded $1.48, and that's the level where current Class I prices are capped at the -- at the average-of mover plus $0.74 as compared to the higher-of mover, 106 months out of a total of 282 months between 2000 and June of '23, or 39.6% of the time, using data from USDA Exhibit 15.

It has more often been the case that Class III prices exceed Class IV by the wider margin, however, not always. And, in fact, in 42 of the 106 instances, or 37.6% of the time, it has been Class IV that has exceeded Class III.

And this is not insignificant. In 2022, in nine of the 12 months, Class IV exceeded Class III by more than $1.48. In July 2023, Advanced Class IV skim milk pricing factor was $3.61 per hundredweight higher than the Advanced Class III skim milk pricing factor, well above the point where producers see any benefit from the average-of mover.

There's no reason to believe that these types of discrepancies will not continue into the future featuring all of the unintended problems we have described.

The Benefits of the Average-of Mover Are Not Worth the Cost to Dairy Markets.

The change by Congress may have been well intentioned, and neither processor nor producer groups anticipated the problems created. The goal of facilitating more use of existing hedging tools by some Class I processors was an idea that, at the time, seemed to have merit with minimal impacts to markets and producers. Obviously, we have seen otherwise. In fact, the demand for hedging of Class I sales is less than clear.

In our own case, our cooperative has four Class I plants and supply a variety of Class I customers which includes retailers, foodservice distributors, and institutions such as schools and hospitals. From the interactions we have with our customers, there has been widespread acceptance of moving prices based on Federal Order price announcements by our conventional fluid customers across our different distribution channels. It's been shared with me that conventional customers have been less interested in pursuing a fixed price if there was any chance that they would be uncompetitive in the marketplace in any given month. Customers have also been reluctant to pursue risk management/fixed pricing, unless it comes at no additional cost to them.

Regardless of the amount hedging occurred in the

Class I market, we would question the disruption of market signals and costs to producers by use of the average-of mover. We recognize that there may be some processors or end users in specialized Class I product channels that may utilize hedging. However, we would contend that it is a relatively small slice of total Class I sales.

By way of illustration, if we assume that this segment represents 15% of total Class I sales -- and this is just an illustration. There's no data that's been presented yet that I'm aware of that tells exactly what that volume would be.

So assuming 15% of total Class I sales, and Class I sales on a national basis are about 30%, the percentage of milk that maybe interested in hedging would, at most, calculate out to be 4.5% of all pooled milk. Obviously some markets have more and some less than the 30% Class I example used. However, the point remains valid. It is likely a relatively small factor in the overall fluid milk market.

While we appreciate that there has been growth in specialized fluid milk products, it is our contention that milk sales of some of these products were strongly trending up prior to implementation of the average-of mover. This was due to changing consumer preferences and the ability of some processors to respond to that demand with innovative products. As such, if the higher-of mover is restored, as we recommend, consumer preferences will drive sales, not the change in Class I mover.

The question we have is whether the cost of disorderly marketing and negative producer returns is worth the benefits it may provide to a small segment of the dairy market. We have discussed how the average-of mover was a significant departure with decades of precedent adopted by USDA and approved by the producer community regarding the movement of Class I prices relative to other class prices since the early 1960s. We believe the answer is clear. The cost is too high and disorderly market conditions too great to maintain the current average-of mover formula.

We will have other witnesses with experience in processing and selling Class I products that will testify to their knowledge and experience regarding the amount of hedging within the Class I fluid product category. The expert industry witness that has already testified, and will again follow me tomorrow, will discuss the specific efficiency of hedging Class I milk and associated issues under different pricing systems.

The 2018 legislation authorized future changes through hearings. The 2018 legislation passed by Congress changed the Class I mover, but also allowed for hearings to amend the Class I formula after two years.

And just taking from that legislative language: "Throughout the 2-year period beginning on the effective date of this sentence (and subsequent to such 2-year period unless modified by amendment to the order)." And that's from Section 1403 of the Agriculture Improvement

Act of 2018.

So the language provided by Congress established this trial two-year period and, in effect, returned future pricing authority to producers and to the judgment of the Secretary of Agriculture. This is important as problems did indeed occur, and wisely, Congress allowed for the changes to be subsequently made through the normal FMMO hearing process.

We are here today to support the reversal of this change and recommend that the Secretary use this authorizing language to respond to problems, albeit unintended, that the average-of mover created.

Restoring the Original Higher-of Class I Skim Milk Mover.

For all the foregoing reasons, the National Milk Producers Federation supports the return to the higher-of mover formula and maintaining current advanced pricing. Reverting back to the higher-of mover will restore more orderly markets and producer confidence in the FMMOs by:

1: Eliminating the asymmetric risk to producer prices and income that was devastating to milk producers under the average-of mover.

2: Enhancing market signals to producers with Class I milk being based on the higher manufacturing class that will improve the timeliness for returning value to farmers closest to when the market is signalling needed milk supplies. The higher-of mover will create better alignment and incent milk to move to Class I use to assure milk is being supplied.

3: Reduce incentives to engage in depooling practices which undercuts the ability to equitably provide returns to producers, which is a separate -- central tenet of Federal Orders.

And 4: Restore the historical concepts of price movement and relationship of Class I prices to other class prices which have long been supported by producers in USDA.

In summary, we support the proposal and language as drafted by NMPF in the hearing petition. The higher-of mover proposal is widely and enthusiastically supported by the producer community. Others testifying at the hearing, including producers and cooperative representatives, will discuss the issues of revenue impacts at the farm level, depooling, attracting Class I milk supplies, and a concern that problems will continue if left unaddressed. They will also discuss the question of a cost benefit of upending decades of experience with price regulation for a small segment of the dairy industry and the failure to find an acceptable alternative to the higher-of Class I mover.

On behalf of Upstate Niagara Co-op and the National Milk Producers Federation, we appreciate the opportunity to testify today, and ask for the consideration of our proposal to return to the higher-of mover for calculating a Class I skim milk mover. And we thank USDA and Secretary Vilsack for holding this

important hearing.
MS. HANCOCK: Thank you, Mr. Alexander.
Your Honor, we would make him available for cross-examination at this time.
THE COURT: Thank you.
It's 8:42. I would like us to just take five minutes to stretch right here in place. I don't expect anybody to leave the room. Let's go off record.
(An off-the-record discussion took place.)
THE COURT: Let's go back on the record.
All right. We're back on the record. It is 8:47 a.m., and I would like the counsel who is at the podium to identify herself, please.
MS. VULIN: Yes. Thank you. Ashley Vulin with Davis Wright Tremaine, representing the Milk Innovation Group.
THE WITNESS: Good morning.
CROSS-EXAMINATION
BY MS. VULIN:
Q. Good morning, Mr. Alexander.
You are with Upstate Niagara Cooperative, correct?
A. That's correct.
Q. How many Class I plants does Upstate have?
A. In my testimony, we have four with milk plants.
Q. And how many are in Order 1?
A. There are three that are pooled in Order 1. Physically, just I think one -- anyway, at least -- at least probably three that are pooled on Order 1.

Q. And where are all the four plants located?
A. Okay. So the four plants, there's one in Buffalo, one in Rochester, one in Syracuse, and one in Williamsport, Pennsylvania.
Q. And you said four -- or excuse me -- three are pooled on Order 1.
The last one, is it partially regulated? Unregulated?
A. It's a state order pool plant, but also partially regulated by the Federal Order.
Q. Which state and which partial order?
A. New York State.
Q. And which --
A. And actually, Williamsport is also regulated by Pennsylvania.
Q. So the Buffalo, Rochester, and Syracuse plants are pooled under Order 1, correct?
A. State that again?
Q. Buffalo, Rochester, and Syracuse plants are pooled under Order 1?
A. No, Rochester, Syracuse, and Williamsport are pooled.
Q. Got it.
And Buffalo?
A. Is a partially-regulated for the Federal Order.
Q. Partially regulated under Order 1 as well?
A. Order 1.
Q. Okay. And how long have you had each of the four

plants?
A. Well, the Rochester and Buffalo plant, going back at least to the '60s. Syracuse has been, I think, within the last five or six years. And I think something similar in terms of Williamsport.
Q. About five years?
A. Something in that -- I don't have the exact dates with me.
Q. And do any --
A. Fairly recently.
Q. I'm sorry.
A. Fairly recently.
Q. Does Upstate sell any branded Class I products?
A. We have some branded products.
Q. What's the breakdown between branded and unbranded, just roughly, percentage-wise?
A. I would say the vast majority are private label. I don't have the exact quantities, but it's probably less than 20% is branded.
Q. And what do you consider to be Upstate's most successful Class I product?
A. I think our, just our regular conventional milk has been successful. But in terms of some sales, some of the chocolate milks that we sell have been popular.
Q. And how many plants does Upstate have that are not Class I?
A. Are not Class I? We have three cultured product plants.

Q. Can you tell me about where those are located and what they sell?
A. So we have a cultured plant in Buffalo, one in Batavia, and one in North Lawrence in Northern New York.
Q. And of the three non-Class I plants, which ones pool their milk?
A. We have milk that goes in that's pooled, but it's not a pool plant, so there's milk that's pooled in those plants.
Q. And under which order is that milk pooled for each of the plants?
A. Most of it is Order 1.
Q. And I don't need any specifics, but does Upstate Niagara have any products that are exported?
A. We do. It's a little bit of -- well, I'm not sure you could consider it exports, but we do have some yogurt products that get into distribution, out of the United States proper that is. But in -- in -- I think -- I think probably the principal export products that we have would be the longer shelf life products from O-AT-KA Milk Products -- that's the eighth plant by the way -- and we do export a little bit of product, evaporated milk.
Q. Sorry. Tell me about the eighth plant.
A. The eighth plant is O-AT-KA, O-A-T-K-A, Milk Products, in Batavia.
Q. And you say that plant sells yogurt?
A. No. That -- that plant sells a variety of products, including butter/powder, retorted products,

including canned evaporated milk and some formulated beverages.
Q. So does Upstate sell products -- or sorry, strike that.
Does Upstate manufacture products in all four classes?
A. Yes.
Q. And for all of your plants, do your plants have exclusively-owned supply milk?
A. We purchase a little bit of milk.
Q. So mostly-owned supply milk?
A. Mostly-owned supply.
Q. And does Upstate send any of its milk to other plants?
A. Yes.
Q. And approximately how frequently, when Upstate is a supplier, how frequently do you negotiate milk supply agreements?
A. Some are annual contracts. Some are just handshake agreements that historically we have supplied over time. Some are longer-term.
Q. When you say "longer-term," you mean more than annual?
A. Yes.
Q. And as a plant owner, how frequently does Upstate negotiate its milk supply agreements when it is purchasing milk?
A. Typically annually.

Q. And do the cooperative-owned plants have to buy the owned-supply milk via a negotiated price?
A. I don't understand what that means.
Q. Does -- do the two arms negotiate kind of independently to come to a price, or is there kind of joint decision-making based on the finances of both?
A. That would be very strange to think that there would be some kind of, you know, negotiation like you would with a third party. So it's determined internally in terms of how that pricing structure will be set.
Q. So different than how you would negotiate with a third party for the milk you are supplementing at the plants?
A. Yes.
Q. And as a supplier, how -- how quickly can Upstate change its buyer in response to market pricing changes?
A. How quickly can we change its price?
Q. The buyers. So -- so, for example, you said you annually negotiate agreements, typically.
A. For our supply?
Q. For your -- and when you are the supplier as well, correct?
A. So when we sell?
Q. Yes.
A. Again, it depends on the -- the contractual arrangement. Most of our arrangements are annual.
Q. So about once a year you would be able to make a decision to shift who you sell your milk to, correct?

A. Yes.
Q. And how quickly can the cooperative members of Upstate ramp up milk production in response to market signals?
A. Well, I think it depends on the producer and how -- what capacity they have to respond. There's a variety of tools that producers have these days to change their milk production output. They can change, basically, their culling habits with or culling strategy in terms of their cow numbers. They can change their feeding profile in terms of how much milk they want to generate depending on prices and opportunities. So there's -- there's different mechanisms that producers can do. Sometimes they cap out in terms of just how many animals they can house. So there's limitations in terms of capacity that would take some time to put on additional capacity.
Q. And what's the time horizon between the decision to ramp up production and when you see results in higher milk volume from a farm?
A. I think, again, it depends on the farm. But some are pretty able to -- to change feeding practices. I would say that, in general, it takes a -- you know, some period of time, whether that's, you know, a month or two, to look at things in terms of what they are doing. I mean, in general, most producers are trying to maximize output most of the time, but there are things that they can do in terms of their -- their rations.
Q. So --

A. And cow numbers.
Q. And I'm just trying to get a sense of the timeline, right? So if the farmer says, hey, I want to -- you know, the market is telling me to produce more milk, and I want to do that, from that decision point to -- to coming up with the feed plan, acquiring the feed, setting that all up, what's kind of the time horizon you see on average?
A. You know, I haven't extensively studied it. But my impression is, is that it may not be a day or two or three. It's probably more like, you know, we're talking more like weeks. But not, like, years. Unless we get into a capacity situation, then it's going to take a little bit of time to respond.
Q. "A capacity situation" meaning?
A. In terms of just the number of -- of the number of square feet that the producers have to house their animals.
Q. So it could be as quick as weeks, or if it takes larger ramp-up efforts, it could be months, potentially years?
A. Yes.
Q. And on the converse, how quickly can suppliers ramp down their milk production in response to market signals?
A. They could cull animals pretty fast, so it wouldn't be a capacity issue. Obviously there's a whole decision regarding cash flow that they are going to take a

look at -- pretty hard at that in terms of what they would do to then recover that in terms of, you know, costs and revenue. But they can sell cows pretty fast.
Q. And as a plant owner, what are the factors -- I don't need the specifics -- but what are the factors you consider in pricing your finished products for customers?
A. What are the factors?
Q. Uh-huh.
A. I mean, obviously that would include costs of our processing and the competitive situation.
Q. Can you be more specific? The competitive situation? What do you mean by that?
A. Well, what are other suppliers of the same products quoting.
Q. And cost of processing, that would include both the cost of purchasing your materials, like raw milk and also all of the manufacturing costs?
A. Yes.
Q. Anything else?
A. Those are the two big ones I can think of off the top. I may have missed something.
Q. And I believe a prior witness testified that over 50% of Class I processing in the United States is now owned by cooperatives. Did you hear that, or do you agree with that?
A. I heard it. I haven't done that calculation or made that estimate, but I heard it.
Q. Do you have any reason to believe that's wrong?

A. I don't honestly know what the calculation is right now.
Q. And on page 5 of your testimony you have Chart 1.
Do you see that?
A. Yes.
Q. And this calculates the difference between what farmers would have been paid if the current average-of -- when the current average-of mover was in place versus the higher-of; is that right?
A. It's the higher-of calculation minus the average-of plus $0.74 per hundredweight.
Q. And this is the difference in what the uniform price would have been?
A. No. This is the difference strictly in what the Class I mover price would be.
Q. And so I'm looking for -- I'm looking at 2020. I believe this is December 2020 when it goes below negative $5.00; is that right?
A. That's correct.
Q. And so in other words, if NMPF's proposed higher-of had been in place, Class I processors would have had to pay $5 per hundredweight more into the pool in December of 2020 because of the cheese price that month, correct?
A. That's correct.
Q. And Niagara Upstate owns a Class I plant, three or four, right?
A. We have four plants.

Q. And so how would -- how would Upstate have been able to absorb a $5 per hundredweight increase in their Class I price in December of 2020?
A. Our Class I prices would be moving with the mover.
Q. And the question is, how would you have been able to absorb a $5 increase in that? Would that have been easy? Do you have that capability?
A. Our conventional milk customers buy milk based on the mover.
Q. And so --
A. Class I price announcements from the Federal Order. So to the extent they go up or they go down, those prices move with that formula.
Q. So you would have passed that price on to your customer?
A. That's correct.
Q. And then they would have passed it on to the consumer you presume?
A. That would be up to them.
Q. And how do you think they would have reacted to the $5 increase?
A. I think it's -- the changes in pricing have been a normal course of business for our customers, so that -- I don't know, because it didn't happen this way, but I presume they would have passed that through as they see fit. May not have passed it through, I don't know.
MS. VULIN: And, your Honor, I would like to ask the witness about an exhibit already introduced,

Exhibit 15. May I approach?
THE COURT: You may. This is Exhibit 15?
MS. VULIN: It is. And I have two copies, so I can give one to your Honor and one to the witness. And I believe everyone else should have copies from prior distribution. And it's online.
THE COURT: Thank you so much.
BY MS. VULIN:
Q. So do you recognize this Exhibit 15?
A. I have seen it.
Q. And at the top it says, "Announcement of Advanced Prices and Pricing Factors, January 2000 to August 2022" -- sorry -- "2023."
Do you see that?
A. Yes.
Q. And if you could turn to page 7 for me, please.
And at the very bottom row, conveniently for us, is December of 2020. And so I wanted to ask you about some of these prices.
So in December of 2020, the Class IV price, Advanced Class IV skim milk pricing factor, was $8.21, correct?
A. Yes.
Q. And the Class III advanced price was $20.07.
A. That's correct.
Q. And under the higher-of, this base skim milk price for Class I, instead of $14.88, it would have been that $20.07, correct?

A. That's correct.
Q. And if that had been the case, which as you all are proposing, the goal would have been to have more money in the pool, right?
A. Yes.
Q. And so in December of 2020, did Niagara -- did Upstate Niagara value its Class I milk at $5 more than it did under the other formula?
A. I'm not sure I understand what you mean by value.
Q. So, Niagara Upstate -- Upstate Niagara's proposal is that this price should have been $5 higher, correct?
A. Yes.
Q. And I'm asking, in December of 2020, was this milk $5 more valuable to you? Did you get a $5 benefit at the time?
A. No. I mean, we passed through, based on the formula pricing with our customers, the price that was announced.
Q. And so the milk wasn't actually more valuable to you at the time, regardless of the formula used?
A. As I said, we base our pricing based on a formula with our customers. So what we valued it at is really kind of subjective. Obviously, our producers were disappointed that the higher-of was not in place and would have reflected a higher price if it was.
Q. But from an objective perspective, you didn't feel the milk that you had in December of 2020 was more valuable because you got to pay $5 less under the current

formula?
A. I don't know how you can feel and be objective at the same time, so I'm not really -- I'm still struggling with this question.
Q. And what I'm trying to tease out is the difference between price and value, right? And so what I'm trying to understand, is to Upstate, if -- what is the value of that milk, or are you testifying that the value is whatever the FMMO price tells you it is?
A. Value is subjective. Value is in the eye of the beholder. That's clear.
Objective is, this is the price announced. It's also clear that under the higher-of, it would have been a higher price, and we would have passed that price through.
Q. Did Upstate's Class I plants have trouble during this time, December of 2020, obtaining milk supplies because of the base Class I skim price?
A. I don't remember that situation. I wasn't in charge of milk handling at that point, but I do not remember that.
Q. So the fact that this average-of was in place instead of the higher-of didn't impact your plant's ability to acquire milk for fluid use?
A. Well, like I say, we have mostly our own supply, and also we have balancing capacity that we can draw on if we're short of Class I needs.
Q. And this issue of market signals and responses. So I'm looking at December, right, where we have this $20

Class III price on page 7?
A. Uh-huh. Yes.
Q. And then if I look to the next page, so we're now on January of 2021, that drops to $10.25.
Do you see that?
A. The which price?
Q. The Advanced Class III skim milk pricing factor.
A. Yes.
Q. So it's roughly a $10 drop from December of 2020 to January of 2021, correct?
A. Yes.
Q. And so this issue of sending correct market signals, the Class III -- the Advanced Class III skim milk pricing factor in December of 2020 was quite high, right?
A. Correct.
Q. And that could have arguably sent market signals to producers to produce more milk to meet that price, correct?
A. Yes.
Q. But then here we are one month later and it drops to $10, correct?
A. Right.
Q. So we probably don't want producers responding to single-month pricing signals given how quickly they can fluctuate, correct?
A. At the supply level, that's correct. But generally, it can be a fairly short time and -- and can be responded to. It also can be responded to by suppliers of

milk selling milk to Class I processors in terms of their incentive.
Q. And so you are saying that the signal that -- that NMPF believes the higher-of would have sent in December of 2020 is to send more milk to Class I?
A. Yes. I mean, over time that's the -- that's been the price signal that we have used historically is the higher value of the Class I milk.
Q. But given -- excuse me. I didn't mean to interrupt there.
Given the Food Box Program and this pricing signal of $20, isn't the market telling everyone to send more milk to cheese?
A. That's -- that's why we need the Class I mover be set at the higher-of so it doesn't artificially send price signals that would draw milk away from Class I milk supply.
Q. Do you believe that the Food Box Program was artificially valuing cheese at such a high level at that time or it was actually that valuable given the program?
A. Again, we're using the value thing. But government, obviously, subsidized the Food Box Program, so they basically artificially subsidized that price to go up. So that's why the -- the cheese price reacted to that in-demand situation from the government program.
Q. Are you saying you believe the cheese price doesn't accurately reflect --
A. No, the cheese price reflects what the price was

in the competitive value of cheese, but it was responding to a government program in the market that stimulated demand and the pricing that responded to it.

Q. And thinking about this December of 2020 example, during this time, if the higher-of had been in place, the intent would have been that less or fewer Class III processors would have depooled and there would have been more money in the pool; is that right?

A. The incentive would have been less to depool.

Q. And if there was more money in the pool, that means under the uniform price, milk for Class IV uses would have been paid out at a higher level, correct?

A. It depends on those comparative prices. If there's higher priced milk in those classes and that it's pooled instead of depooled, it would tend to support the uniform price.

Q. And you can see the prices here at the bottom of the page. Is that true under the prices you see here with Class III at roughly $12 less?

A. Which price are we talking about?

Q. Still in December of 2020, at the bottom of page 7.

A. Okay. We're back on page 7.

And we're looking at which price, the Class IV price.

Q. Well, I'm asking if -- if -- if NMPF's proposal had been adopted --

A. Yes.

Q. -- and the higher-of had been in place, and there was more money in the pool because you are incentivizing milk to stay in the pool, the uniform price for all milk would have been higher, correct?
A. Yes. That's correct.
Q. And so Class IV processors and suppliers who supplied Class IV that were in the pool, those suppliers would have received a higher price for their milk as well, correct?
A. Their producers would have received a higher price, yes. I mean, there would be a -- there would be a draw from the pool --
Q. So wouldn't that have made --
A. -- for their producers.
Q. I'm sorry, I didn't mean to interrupt.
A. Yes, for their producers. It's not processors that would get that.
Q. I'm sorry if I misspoke there.
So if the -- if the producers who supplied Class IV got more money from the pool that month, wouldn't it be harder, then, for Class III to attract milk from Class IV if -- if needed to fulfill the needs of the Food Box Program?
A. I think there would have been similar incentives in either case to -- to move milk where it's needed. So if milk was needed by a Class III processor, they would have paid for that milk.
Q. The Class III processor would have.

A. Yes.
Q. And wouldn't they have had to pay more because a supplier who was supplying Class IV would have received more milk from the pool that month under the higher-of?
A. It's possible. I don't know that that's what would have happened. I mean, you are asking me for a, you know, a scenario that I'm really not sure how that would have transpired.
At least in our case, if a manufacturer needs more milk, we try to supply that to them. We know that in either case there will be a draw from the pool for our producers. So really there's -- there would -- we would try to react to the needs of our customers.
Q. Don't you believe it's important for NMPF and all of us here to consider how NMPF's higher-of proposal could and would disrupt price signals between III and IV?
A. Well, I think in terms of what we know, and we know that Class I has been the driver of how this program works over the years, really Class III and Class IV are ancillary to the objectives of the program. That's why, you know, we focus so much on the Class I price and why it's so important to us to restore the higher-of.
Q. If Class III and IV are so ancillary, why a proposal that is designed to incentivize Class III to stay in the pool?
A. Because we -- a couple different reasons. First of all, when depooling happens, then we know that there's other returns and other prices that potentially are in the

market, both to producers and to processors in terms of what they are paying for milk. So the idea with Federal Orders, at least in terms of pooled milk, is we try to achieve equal -- or equity in terms of returns to producers and equity in terms of raw product cost to processors of like products. So when there's depooling, there's a potential that both of those conditions are violated.

Q. So Class III and IV aren't ancillary to the program, the FMMO program?

A. They are important in terms of making sure that there's competitive equity, but they are not the driving force in terms of Federal Order pricing.

Q. And you mentioned depooling.

Do you believe depooling is disorderly?

A. Depooling can be disorderly. It's a symptom. Right now -- and this has been discussed quite a bit here at this hearing, it's quite a bit over the course of time with Federal Orders -- depooling is a symptom. And it may not be that you ever eliminate depooling, but depooling tends to be a symptom in terms of a problem.

And like I said before, and others have said, it starts to look like there's different prices out in the market being paid for producers. So if a processor depools their milk, now there's a different potentially return for that milk. They are basically not contributing into the market pool anymore, they are able to basically keep that money either for their producers or for their company, and it's not being paid, so that's potential for different -- different costs of -- of pricing to producers and to the processors themselves.

If you pull milk out of the order, and it's not available to Class I processors, and a Class I processor needs that milk, now all of a sudden there's not a sufficient signal to draw that milk. They have to go out and potentially pay a premium to get that milk away from that -- that processor.

Q. But you would agree with me, the Federal Orders can't require Class III to pool their milk, correct?

A. While they can't require it, it's voluntary in that sense. Really the lever that USDA has used principally and what is the subject of this hearing is not pooling regulations, it's about pricing. Pricing signals incentivize the pooling of milk, and right now we don't feel that there's proper price signals in terms of those -- in terms of the pricing of the milk for pooling purposes.

Q. And do you -- you don't agree that performance standards are how FMMOs can incentivize Class III participation in the pools?

A. Performance standards can assist with that, that's true. Performance standards, in and of itself, is not a prime -- necessarily a prime objective of the Federal Order system. The idea really is to reflect equitable prices to producers in terms of the value of Class I milk and -- and -- which is sharing in the benefits of that higher value with -- with producers as well as I guess what's historically called the burden of that reserve supply, which is the lower class prices.

Q. And you said the concern with depooling is that it draws milk away that is needed for fluid use, correct?

A. It can, yes.

Q. So if there's more than a sufficient supply of milk for fluid use, depooling would not be disorderly, correct?

A. It's depends on the situation. It depends on who has the milk and who needs it, where it is, what day of the week it is, what time of the year it is. So it's a variable situation. Because on average, it looks like there's a surplus of milk to Class I use doesn't mean there's a sufficient supply every day of the -- every day of the year. And it changes the incentive structure in terms of supplying that milk if those options exist to go outside the pool.

Q. But in response to a situation that you describe as variable, geographically, temporally, day by day, you are asking USDA to set a national pricing formula based on incentivizing Class III to stay in the pool?

A. We're asking for a host of reasons. That is one aspect of the pooling issue. The whole package of proposals that National Milk has includes things that we feel will help assist USDA and assist our nation's farmers in terms of incentivizing pooling.

Q. And in the -- in the market areas where Upstate

operates, is there a currently a sufficient supply of milk for fluid use?
A. Yes.
Q. So in those areas, you would agree with me we don't need to incentivize Class III participation in the pool in order to ensure there is sufficient supplies of fluid milk?
A. We have sufficient supplies today. We don't -- haven't always in the past. There's been time periods in the past where it has been difficult to -- to supply Class I milk.
Q. But today --
A. Generally speaking, we have our supply. So we can -- we can move milk to where we need it, when we need.
Q. And I'm asking about kind of the marketing area, right? So Federal Order 1, have you heard of anyone else having any trouble having -- obtaining a sufficient supply of milk for fluid use?
A. Not currently. But over the years I have attended call hearings and -- and in the -- what was the old New York/New Jersey Order 2 where there wasn't enough milk to supply Class I processors because the manufacturers didn't want to give it up.
Q. What year was that?
A. Technically there was more milk than Class I sales, but because of the incentive structure, they didn't need to -- to -- to send any milk, there wasn't any purpose for them to do it, so it was -- they'd have to

call a hearing to discuss how to supply those Class I processors.
Q. What year was that?
A. That was back in the late '80s.
Q. Okay. So it's been quite some time since that has happened?
A. Quite some time. But over -- since that time, there's been occasions when there's been short supply, especially in the fall.
Q. And I have an exhibit that I would like to distribute. I did not write down the next exhibit number, I'm sorry.
THE COURT: Isn't it, so we're right now on 245. Would it be 246? 246.
MS. VULIN: Exhibit 246. And we have copies coming around.
(Exhibit Number 246 was marked for identification.)
MS. VULIN: May I approach?
THE COURT: You may.
MS. VULIN: Thank you.
BY MS. VULIN:
Q. Now, this document is entitled Federal Milk Market -- Federal Milk Order Number 1.
Do you see that at the top?
A. Yes.
Q. And the subject is, "Request to reduce fall month shipping percentages, approved 10% for 2022 and 2023."

Do you see that?
A. Yes.
Q. Do you recognize this document?
A. I have seen similar documents in the past.
Q. Uh-huh. If you look halfway down the first page, it says "Petition."
"In their 2022 petition Queensborough cited declining Class I sales, a decline in the number of Class I customers seeking to purchase milk for Class I usage, and a comment that they, as a longstanding participant of the Northeast Dairy industry, were unaware of any instances where Class I needs have not been covered."
Do you see that?
A. Yes.
Q. So this document reflects that in 2022, March of 2022, Queensbourough requested that the shipping percentages in Order 1, under Section 1001.7(c)(2), be reduced from 20% to 10% for September, October, and November.
Do you see that?
A. Yes.
Q. Do you recall this request?
A. I recall that. Yes.
Q. And if we go to the very last page, please. This is a letter that Upstate submitted in support of that request.
Do you see that?

A. Yes.
Q. And do you -- did you have any involvement in the submission of this letter?
A. I remember seeing a -- a draft of it.
Q. And you didn't tell everyone, don't send that, we need more fluid milk?
A. No.
Q. Okay. And if I read under the "lowering shipping percentages heading," it says, "Upstate Niagara does not oppose the request to lower the shipping percentages for this year. The downward trend in Class I markets is well-documented. While we keep adjusting the percentages to accommodate milk that's willing to service the market in the spirit of preventing disorderly marketing by uneconomic and unnecessary movements of milk, we must also recognize that there simply isn't the same requirement for as much milk to service the declining fluid market.
Do you see that?
A. Yes.
Q. And you don't disagree with that, do you?
A. No. But I would continue on further with the next paragraph where there's been requests for more permanent changes. And because of the past experience with volatile supplies and demand at times, we would prefer to see the market order look at it periodically to the assess whether, in that particular situation, for that particular year, there's an adjustment.
Adjustments are not new. They could also go up.

Q. And do you recall if the MA's office granted this request?
A. I believe they did.
Q. Uh-huh. And did they grant it for two full years, 2022 and 2023, for that September to November window?
A. I don't recall.
Q. If you go to page 6, which is at the top right corner, you will see there it says, halfway through, down the page, "Considering 2022 will be the fifth year in a row that the shipping percentage will have been reduced to 10%, and given that the market conditions that warranted previous reductions continue to exist, the reduction in the shipping percentage to 10% will apply to September to November for years 2022 and 2023."
A. I see that.
Q. Okay. So it looks like the request was granted.
A. For a limited basis as opposed to permanent.
Q. And -- but you, on behalf of Upstate, still maintain that the higher-of needs to be in place in order to attract more milk to Order 1?
A. We believe that over time it's the correct incentives to put in place to move prices.
Q. And I'd like to finish up by asking you about a statement you made about hedging. It's on page -- one of the last pages, I'm sorry. Page 8.
Under "the benefits of the average mover are not worth the cost to dairy markets," the second paragraph, you say, "In fact, the demand for hedging of Class I sales

is less than clear."
And then you go on to recognize that there are some processors that may utilize it, but that you believe it is a very small slice of Class I total sales; is that right?
A. That's my opinion. I'd be interested in other data that shows that it's significant.
Q. So it's merely an anecdotal observation of yours that Class I --
A. It's our own personal experience in terms of our customer base, that there's not a demand for hedging.
Q. And I just want to make sure I can finish my question, so just let me -- that's why my hand was trying to give you the signal.
So just to be clear, it's only your own observation on behalf of Upstate that you don't believe that Class I is engaging in significant amounts or meaningful amounts of hedging?
A. That's my opinion. I don't know.
Q. You haven't undertaken any kind of survey or analysis of the extent of Class I hedging utilization by Class I?
A. Just conversations with people. I don't have any survey data.
Q. And you -- you said that because Class I utilization itself is so low, if Class I engages in hedging, that will also be a small part of the market; is that right?

A. Correct.
Q. And -- but isn't it true that Class I utilization is low because it's been on a downward decline for years?
A. It's been moving down, yes.
Q. Uh-huh. And so wouldn't you think that it would be important for Class I processors to have at their disposal tools necessary to slow that decline?
A. Not at the cost of dairy farmers.
Q. And you would agree with me that Class I processors are the only ones who can't opt out of the pool, correct?
A. If they are pooled under the Federal Order, that's correct.
Q. And if the goal of FMMOs is to ensure a sufficient supply of milk for fluid consumption, wouldn't it be extremely important to ensure that Class I processors are able to utilize risk management tools?
A. That's one of the goals. If it's at the cost of impacting -- negatively impacting producers in terms of income and uniform pricing, then that's why I believe it's questionable that a small fraction can impact the rest of the market that way.
Q. So is the goal of ensuring income for farmers a more important goal under the FMMOs than ensuring a sufficient supply of fluid milk?
A. That's an important goal, sufficient supply of milk. But one of the ways to do that is to assure that producers are receiving fair income.

Q. Okay. So -- so just -- I just want to be clear there. The assurance that farmers are receiving sufficient income for their milk is not an independent goal of FMMO's. It is only a goal so far as that is necessary to ensure a supply of fluid milk?
A. A -- right. That's a supply of fluid milk.
MS. VULIN: Okay. Thank you. No further questions.
Oh, and I did promise I would return Exhibit 15, unless others may want it.
And I also would like to move admission of Exhibit 246, please.
THE COURT: Let me ask, are we going to wait for a motion to admit 245 until cross-examination and redirect are completed?
MS. HANCOCK: That's what we have been doing, your Honor.
THE COURT: All right. And I think I will wait on your motion until I can deal with them together.
MS. VULIN: Okay. Thank you, your Honor.
THE COURT: So it's 9:31, if there's going to be another examination of Mr. Alexander by another person, and I think it looks like there will be, I would like for us to take a ten-minute break right now.
So let us go off record at 9:32. Please be back and ready to go at 9:42.
(Whereupon, a break was taken.)
THE COURT: We're back on the record. It is 9:43.

Counsel, would you please identify yourself?
MR. SJOSTROM: Good morning, your Honor.
Lucas Sjostrom for Edge Dairy Farm Cooperative.
THE COURT: Would you spell all of that?
MR. SJOSTROM: I had earlier, but I certainly can. L-U-C-A-S, S-J-O-S-T-R-O-M.
THE COURT: Thank you.
MR. SJOSTROM: Thank you, your Honor.
THE COURT: You may proceed with your cross-examination.
MR. SJOSTROM: Sure.

CROSS-EXAMINATION

BY MR. SJOSTROM:
Q. Good morning, Mr. Alexander.
A. Good morning.
Q. Just a few short questions pertaining mostly to the farmer side risk management.
A. Okay.
Q. So as a farmer, I'd just like to ask you some questions.
Today is September 25th. You mentioned the pricing was done the 23rd or before, correct? The advanced pricing happens on the 23rd of each month or before.
A. Yes.
Q. Thank you.
And so we'll just -- we'll just keep today as the September 25th and not talk about the 23rd and get

confused.

And just curious, if you were managing a budget as a farmer, would it be easier if I told you the amount of your paycheck in October today or would it be easier if I told you that on the -- some of the first five days of November? Which would be easier for you to manage your budget?

A. I suspect it would be easier if I know.

Q. And -- thank you. And if --

(Court Reporter clarification.)

THE WITNESS: It would be easier if you knew the price.

BY MR. SJOSTROM:

Q. Today already?

A. Yes.

Q. Yes. Yes. Thank you.

And if you were going to be short on cash in October because you needed to make a big purchase for borrowing and for risk management purposes, would it be better for today or for November, to know?

A. I suspect that if you knew today, that would be best. But if you had a reasonable forecast, that would probably be helpful as well.

Q. Thank you.

And then, finally, would it make sense in that setting if -- if you as a -- you know, if you were paying the co-op milk checks, if you paid some farmers today and you paid other farmers -- or excuse me.

If you told some farmers what they were going to get paid today and told other farmers what they were going to get paid in November for their October milk, do you think that would be a significant advantage or disadvantage for farms? And I know this doesn't happen, but in that scenario, is that -- do you think that would be a disadvantage and advantage to some farmers versus others?

A. It's possible.

Q. Okay.

MR. SJOSTROM: That's all the questions I have. Thank you.

THE COURT: Thank you.

Additional cross-examination of Mr. Alexander?

Would you state and spell your name, please.

DR. BOZIC: Good morning, your Honor. Marin Bozic for Edge Dairy Farm Cooperative, M-A-R-I-N, B-O-Z-I-C.

THE COURT: Thank you. You may proceed with your cross-examination.

CROSS-EXAMINATION

BY DR. BOZIC:

Q. Good morning, Craig. How are you today?

A. Good morning.

Q. Would removing advanced prices help reduce depooling? If we didn't have advanced pricing, would that help reduce depooling?

A. It's one of the things that could help. There's other things that can help. That's part of the package of

our proposals is to help get the pricing signals correct.
Q. Would removing advanced prices help or hurt producer risk management?
A. I'm not an expert on risk management related to hedging. I have hedged some commodities, but -- but as far as farm price hedging, there's others that are better at explaining that.
Q. Sure.
Does -- in your opinion, does the average-of make it easier for fluid milk processors to engage in risk management than the higher-of approach?
A. I know that some believe it is that are testifying here. We also had some testimony that there's complications in any case for Class I hedging, whether it's the higher-of or average-of.
Q. What would be closer to truth, in your opinion?
A. I -- again, we don't have customers that require it. I suspect there's inherent issues in both circumstances. And I think there's probably some other implications in both circumstances in terms of other effects on the market.
Q. Would depooling in 20- -- that happened in 2020 and 2022, would it have happened even if we had the higher-of?
A. I suspect that there would be some depooling if we had. But the point of the matter, and I want to underscore this, it's a complicated subject with many factors that influence depooling decisions. The Class I

mover is just one of them. Advanced pricing is just one of them. And -- and there's pros and cons of every one of those issues. We believe there's more pros to going back to the higher-of in terms of assisting the uniform price be reflected back to producers in a proper fashion. We also believe, on balance, keeping advanced pricing is a benefit to the industry that overcomes the issues in terms of advanced pricing impacts to advance price relationships.

Q. Are you familiar with the Edge's proposal, I believe it's Number 17 or 18, that would return Class I mover to higher-of but at the same time remove advanced pricing?

A. Yes.

Q. So I understand that your cooperative opposes that proposal, but if you could entertain a thought experiment.

Let's say that that is indeed a proposal that AMS offers in their recommended decision, in their Final Decision, and it is indeed approved referendum. So let's -- if you could work with me off that scenario where it becomes the state of the play.

How would your cooperative change its practices if that were indeed to become the regulations under which you must operate?

A. Well, just because that changes, doesn't mean that our customers are going to say yeah, that's okay, we don't, really care about the price until after the month is over.

Q. Right.
A. They are going to want to know. They are going to want to know what their price is in advance. So somehow Upstate would have to figure out a way to deal with that, inherently increasing the risk that we would have in terms of how to manage through that situation, in terms of how far we announce prices, what we would have to do to deal with that. And so, you know, we feel that that creates more risk actually back to our cooperative owned by producers in that circumstance.
MS. TAYLOR: Mr. Alexander, excuse me for interrupting. Can you make sure you talk closer to the mic?
THE WITNESS: Yeah. Sorry.
BY DR. BOZIC:
Q. So sticking with that thought experiment, if CME were to introduce a new futures contract that settles on the base Class I mover as announced by USDA, would it be fair to say that one of the ways you could manage that risk is by entering into a futures position that would then allow you to offer a price to your buyers on or before the 23rd of the prior month?
A. I can't say for sure just how that would transpire, but I can tell you that it adds a new wrinkle in terms of our strategy. It adds a new wrinkle that creates potential for differences between us as a seller of packaged milk products and other sellers. Again, that creates additional risk in terms of what happens in the

marketplace. It would be a pretty dramatic change from historical standards in terms of how we have dealt with prices under Federal Orders, even probably prior to Federal Orders.

Q. In your testimony you listed several major dramatic changes: In the '60s, introduction of FMW; in the late '90s for BFP; and then the order consolidation reform. So we've had dramatic changes in the past. We mostly survived.

Times have changed. Would you agree that the times today are quite different than 30 years ago?

A. Milk is still perishable off the farm.

Q. But the markets that we have available for risk management are much more mature than 30 years ago.

Would you agree with that?

A. They are more mature, but doesn't necessarily solve all the problems all the time.

And hedging carries cost. They are more costly than -- I guess if you want to call it self-insurance, there's definitely more cost attached to hedging. So that's -- that's definitely a situation that somebody's going to bear that cost.

Q. So I'm not an attorney, so I don't go always off the script. I try to engage in intellectual exercise.

A. I know, it's hard.

Q. So let's say that the cost of hedging is to the tune of let's say $0.07 a hundredweight.

What if USDA were at the same time to remove advanced pricing and increase the base Class I differential by $0.07, would that be a way to address the increased hedging costs?

A. It -- I mean, that's a way. I don't know that that would solve the problem. Certainly there's plenty of other problems. I don't know how that would work in terms of actually recovering that -- that value.

And it doesn't necessarily solve the problem in terms of customers that want to be assured that their price basis is the same as others. In other words, they don't want to lose out. And some of our conversations internally have been that customers are most concerned about their competitive situation in the market.

Q. But, Mr. Alexander, assuring that all customers are guaranteed the same price, wouldn't that run contrary to some principles of competitiveness, where they have to compete with others for best price, for market share, for customer loyalty, etcetera?

A. Well, I think you could argue that, you know, deregulation of the Federal Milk Market Order system creates competition. The question is, is it competition that extracts a toll on dairy farmers.

Q. I would agree that it extracts a toll on dairy farmers. And I hope that we can agree that what we are discussing in the context of advanced pricing is not a deregulation, rather than change in regulation of pricing.

Would you agree with that?

A. I think there's some concern as far as where we're going in terms of the various practices and various proposals. But I'm okay with saying that in this case it's limited, but I have -- I have concern. I mean, we -- we -- we experimented with the average-of. We found problems. Experimenting with something like removing advanced pricing is disruptive to decades of past practice. I'm not sure how it would work out.

Q. But -- okay. But, you know, National Milk is offering other experiments in their package, including periodically updating protein tests and butterfat --

A. Those aren't experiments, Doctor. I have to disagree. Those aren't experiments. Those were fundamental bases of moving to milk component pricing was using average composition. So I mean, those are things that are being updated. They are not being radically changed.

Q. You just said that removing advanced pricing would add a wrinkle to what your cooperative would do.

But wouldn't it, at the same time, add some bulldogs, or remove a wrinkle for dairy producers who are doing risk management?

A. Again, I'm not an expert on how it -- it -- the advantages and pros and cons in terms of removing it. I think it -- like I say, I know it creates a problem, and our co-op doesn't support it.

DR. BOZIC: Thank you for your answers.

THE WITNESS: Thank you.

DR. BOZIC: That's all.

THE COURT: Thank you.
DR. CRYAN: Good morning, Craig.
THE WITNESS: Good morning, Roger.
THE COURT: Please state and spell your name.
DR. CRYAN: My name is Roger Cryan with the American Farm Bureau Federation, R-O-G-E-R, C-R-Y-A-N. Thank you.
THE COURT: Thank you.

CROSS-EXAMINATION

BY DR. CRYAN:
Q. Good morning.
A. Good morning.
Q. You talked about -- you -- in response to, I think a question from Dr. Bozic, you said that you have concluded that the benefits of advanced pricing outweigh the disadvantages.
Did you -- could you elaborate what are the benefits of advanced pricing of Class I?
A. Well, we're likely to have -- I didn't necessarily intend on testifying today about advantaged pricing.
Q. Right.
A. So it's very likely that we're going to have some further testimony from some others about that.
But I know for us, it allows for pricing to be reflected to our customers, and you can get a sense as a supplier as far as directionally what prices -- how prices are moving. Not having advanced prices creates a slew of issues starting with, well, what price do you announce,

how you come up with it, how do you get your customer to support it.

And -- and then, depending on what happens, after the fact, can you recover any differences that would have happened if you had had pricing in advance, or is there any true-up, so to speak in terms of the difference, between the actual and what you had forecast for that customer. That can cut across a whole range of issues and different customers in terms of how you do that.

It's not clear to me that the -- that that's a panacea in terms of being able to implement some of those things without additional risk to us as a producer-owned processor of Class I products.

Q.   So if I understood right, you were talking primarily about timing and the ability to price for customers, and that that gives you the ability to price for customers just before the month of --

A.   Correct.

Q.   -- but also in response to Dr. Bozic, you talked about the wider range of potential opportunities the Class I futures contract would -- would create. And then you began to -- you had a couple thoughts on that.

But could you elaborate on that?

A.   Which part?

Q.   The -- the potential -- you talked about the potential for pricing for customers based on the existence of a Class I futures contract, if such a contract existed.

Is that -- that would address the kind of issues

you are talking about and let you go beyond that? As I understood it from what you were saying, it would go beyond that to provide longer-term fixed pricing, to do more than just knowing what the price is on the 23rd of the month before.
A. Well, first of all, the fact that we don't do it, we haven't had customers that want it, kind of speaks to why are we -- why would we -- why are we going down this path.
But -- but, you know, beyond that, I think that it's not clear to me what those opportunities would be, I guess, and would really depend on, you know, kind of where we are with customers in terms of how that would impact them, and whether they would subscribe to it, how we would execute it. And so I think it's a -- it's an open question.
And the advanced pricing has worked literally for decades since the infancy of probably commercial fluid milk pricing, even before Federal Orders. So it's not clear to me just exactly how that new opportunity, what would be the demand for it, and how would it be used.
The more uncertainty there is around pricing -- I don't think our customers like uncertainty. They -- they like knowing that the price basis is going to be pretty consistent amongst their competitors. And now going to a new basis, they are going to say, well, yeah, maybe that looks good, but, gee, next month when somebody is offering a low price, they are going to say, well, what's their

basis for their -- their price?
So it's very difficult to know how that would work out. It would be very difficult, also, to -- potentially to administer.
Q. Is part of that -- that answer that folks are -- they haven't had opportunities to do the longer-term pricing, so they are not used to that, and the long -- the decades of practice just means folks are used to the current advanced pricing?
A. Well, some of those buyers are pretty used to pricing in other products, in other dairy products. Some may be more interested than others; some may depend on whether it's their own label or a branded label. But, again, I can only speak to, you know, at least our experience is, is that there's been satisfaction with how prices move in terms of Class I.
DR. CRYAN: Okay. Thanks very much.
THE WITNESS: Thank you.
CROSS-EXAMINATION
BY MR. MILTNER:
Q. Good morning. My name is Ryan Miltner. I represent Select Milk Producers. It's R-Y-A-N, M-I-L-T-N-E-R.
Good morning, Mr. Alexander.
A. Good morning.
Q. I wanted to ask you a few questions based on USDA's discussion during Order Reform about setting the Class I mover. And there were, as you recall, probably

several different issues they were trying to balance. But they made a few statements, and I wanted to ask you about Upstate Niagara's experience and your thoughts on those points, if I could.
So in 1999, USDA wrote that there were several conflicting issues that they have to balance when setting the Class I mover. The first is, as they stated, the retail demand for Class I milk is independent of the demand for manufactured dairy products.
Do you believe that's still the case today?
A. That tends to be the case.
Q. The second is, the raw material used in both Class I products and manufactured dairy products is the same and, therefore, the separate uses must compete for the given supply of milk.
Do you believe that's still the case?
A. Yes.
Q. Third, the elasticity of demand for the various dairy products is significantly different creating different consumer responses to the changing prices for various dairy products.
Do you believe that is still the case?
A. Yes.
Q. Now, in terms of just generally having a Class I price that is higher than the manufacturing classes, USDA wrote that the higher price also allows Class I uses of milk to compete for the raw milk supply against manufactured dairy products.

Do you believe that is still an important objective of the pricing structure?
A. Yes.
Q. Now, further in its discussion -- and, again, they are balancing lots of different options, including of a higher-of and including the timing of price announcements in this discussion -- but USDA writes that overvaluing Class I milk -- excuse me -- "undervaluing Class I milk is a particular problem since it reduces producers' pay prices at a time when producers should be receiving a positive price signal."
Do you agree with that statement as well?
A. Absolutely.
Q. Now, if we look at just this narrow issue that's part of Proposal 13 about moving to a higher-of versus an average, do you believe that one of those two options is better at giving producers the price signal that USDA found was important?
A. Yes.
Q. Which one?
A. That's the higher-of.
Q. And can you explain just briefly why you think that's the case?
A. Well, it's a clear signal that it has a higher value than the alternative manufacturing class prices. So it's a clear signal, both to producers and then also to others in the marketplace, in terms of the relative value, so that Class I processors can compete for milk and

producers can get the signal to supply it.
Q. And then I think this is my last question.
USDA wrote, again, further in that 1999 Order Reform decision: "When the effective Class I differential is negative, it places fluid milk processors and dairy farmers or cooperatives who service the Class I market at a competitive disadvantage relative to those who service the manufacturing milk market."
Is that the experience of Upstate Niagara?
A. Yes.
Q. Do you believe that moving to the higher-of would help to minimize that type of occurrence?
A. It would help.
MR. MILTNER: Thank you. I don't have any other questions.
THE COURT: Is there any further cross-examination of Mr. Alexander?
MS. TAYLOR: AMS has some questions.
CROSS-EXAMINATION
BY MS. TAYLOR:
Q. Good morning.
A. Good morning.
Q. Thanks for testifying today.
A. Sure thing. It's been a while coming.
Q. I want to turn to page 8 of your statement. Make sure I don't spill my coffee.
Under the header there you have "negative impacts are likely to reoccur."

And so your first paragraph you calculate the difference when -- the number of times when the difference between III and IV exceeded $1.48?

A. Correct.

Q. But in the second paragraph you talk specifically about when IV exceeds III.

A. Yes.

Q. I'm just wondering if you could illuminate why you pointed that particular situation out. Why is that important?

A. I chose it because there's an assumption by some that Class III is always the driver of these markets, and at times it has been. At times, for example, when we had the support program in effect in the early 2000s, there was surplus product nonfat, and that tended to depress the market.

But more recently, as we have become more exporters of nonfat dry milk, and, you know, we see that there's changing capacities in terms of cheese production, it's very possible that Class IV -- and, in fact, in the past year and a half, we have seen Class IV actually become more often a driver of what is the higher price, manufacturing price.

The other thing I want to mention here, and something I didn't put in my testimony, but it's kind of a particular aspect of the Class III skim formula. And interestingly, while one product, nonfat dry milk prices, impact the Class IV skim price, multiple ingredients impact the Class III skim price. So prices changing for cheese, prices changing for whey, and prices changing for butter.

So holding cheese prices and whey prices constant, if you increase the butter price, you reduce the skim value. So it's kind of an unstable price just because of how it moves. And so having the higher-of and having that other aspect of Class IV kind of providing a little bit of a balance to that, we think is another aspect that makes higher-of a better idea.

Q. Okay. On the bottom part of the page under the next header, "the benefits of the average mover aren't worth the cost to dairy markets," you talk about not -- and I know you have had some other questions, so not by first-person experience, but you have talked to people that have said that your customers aren't looking to do risk management.

And was it your impression that the average-of mover was meant for processors to be able to do risk management or for the processors' customers to do risk management?

A. That's actually a good question that I'm not sure of the answer on that, whether it was for customers or for the processors themselves, whether they were faced with situations where that made it advantageous to them to hedge or whether it was their customers demanding it, so I don't know the answer because we don't engage in it.

So that's a good question, but I don't know the

answer.
Q. Okay. On the bottom paragraph there the second part of the first sentence reads, "We would question the disruption of market signals and cost to producers by use of the average-of mover."
And you have talked about those disruptions a lot. But I was wondering if you could speak to how you -- under orderly conditions, how you would expect market signals to be transmitted?
A. Under?
Q. Orderly marketing conditions. You've talked about the disorder you have seen from -- in your opinion, from moving to the average-of. But could you talk some about, well, what is orderly marketing and proper price -- what you would consider proper price signals to producers?
A. Well, proper pricing means that what goes into the pool reflects market values as -- you know, as we have kind of operated with in terms of classified pricing. So -- and because -- because we have operated with Class I being the highest priority or highest price, then we believe that orderly would mean that that price would be reflected and go into the pool. That would then enhance the uniform price paid back to producers.
So we feel that would be an orderly circumstance just in terms of price transmission from -- from basically the market back to producers. It would also be proper in terms of pricing for Class I processors in terms of what they do in terms of communicating the price forward.

It also means that -- that -- you -- we talked about some of the aspects of depooling, which is a complicated subject and really kind of a difficult one to necessarily solve all of the issues and incentives for depooling. But obviously adding money into the pool when it makes sense, which is with the higher-of, helps the uniform price be where it is to help reduce the depooling. Doesn't eliminate it, but it would help reduce it, so we feel that's orderly.

When you have depooling, then you have the situation where you have multiple prices out in the market. You have the possibility that, in order to -- for a Class I processor to get milk, they might not be competitive or they might not -- they might have to pay higher costs in order to gather that milk in terms of over-order premiums just to get a supply, if they could get it.

So those are kind of a few things that -- that normally order regulations try to -- you know, try to incentivize. There's only, in this hearing anyway, levers related to pricing to kind of send that signal to operate correctly. There's other issues that have been brought up regarding pooling requirements, but those aren't the subject of this hearing.

Q. Speaking of kind of pooling requirements, in the Northeast, it's been discussed at this hearing a number of times how things are different up there, different type of pooling standards that keep milk on the order.

So can you talk about -- and I don't know if I read -- gathered from your statement, in particular, the experience in the Northeast during COVID when the price signals were what they were, as you would call them disorderly, and how that impacted things in the Northeast where it was a little more difficult to get on and off the pool.

A. There was less depooling, so that the way those provisions work to create longer-term pooling. But decisions can be made in certain time periods where milk can be depooled. I know that June of 2020, I think, was one of those months when significant milk was depooled.

So do those provisions help? They help, but not necessarily in the long run. And we talked about depooling being one aspect of the problem with the higher-of. It's not the only one.

So while that provision helps in the Northeast for now, you know, I think that it's reasonable to say that that's -- that's been a help in terms of the depooling issue.

Q. It helped, but you still saw some depooling -- people still made the decision not to pool milk --

A. Yes.

Q. -- even with those stricter standards?

A. Yeah. And I think, you know, back to the aspect of our package of proposals, higher-of, component issue, change in the elimination of the barrels, the Make Allowance, the Class I price service, all those

things together will change incentives on pooling, and we think for the better.
Q. Okay. Thanks.
This is my last question. And I know your statement kind of takes a guess at perhaps how much milk might be using risk management tools, so you can't necessarily speak to actual experience. But since Upstate doesn't use it, is there -- is there, like, a threshold maybe at one point you would consider using risk management or that's just not on the cards for the co-op?
A. Well, to some degree it's an aspect of a competitive situation. So -- so I -- I can't really speak to at what point we would say, hey, you know, we're going to do it. I think that, you know, if we saw a number of customers that -- that started to say something about it, I mean, the first thing we would do -- and it doesn't take a change in the mover to necessarily start to have that conversation. As Ms. Dorland talked about, talked to our hedging person and -- and asked them, is there some opportunities for creating an over-the-counter swap or something where we could design something that would address whatever hedging goal a customer might have. So that would be a possibility.
But I think, you know, one of the concerns we would have is that it opens the door of an already pretty open door in a competitive market to more factors to worry about in terms of how to price milk.
Q. Okay. I always think of one more, but I went back

to my first page.
For Upstate, you talked about you have 250 farmer members. Can you talk a little bit about the size of those farms when it comes to the Small Business threshold? And if you are not sure what that is, I can repeat it again.
A. Yeah. I was provided with the percentage being something like 85%.
Q. Are small?
A. Yeah, that's looking at milk revenue and not at other sources of revenue on those farms.
Q. Thank you.
And does Upstate offer any risk management tools to its producers?
A. We used to. I don't think we do very much at this point. I think they have addressed the issues in their own private ways, if at all.
Q. Okay.
MS. TAYLOR: I think that's it from AMS. Thank you so much.
THE WITNESS: Thank you.
THE COURT: I knew that Erin Taylor's questions got everybody thinking, and I see that there are some more questions from you others. And I will invite that, and then I'll ask again, Ms. Taylor, to follow up if she has anything before we have redirect.
So who would like to be the first again to cross-examine Mr. Alexander?

MR. LAMERS: Mark Lamers, Lamers Dairy, Appleton, Wisconsin. That's L-A-M-E-R-S.

CROSS-EXAMINATION

BY MR. LAMERS:

Q. Good morning, Mr. Alexander.

A. Good morning.

Q. There's a lot of talk about using the Class I mover along with the Class I differentials as to help prevent depooling.

And would you agree with me that the original intent of the Marketing Agreement Act is to provide uniform blend price to producers?

A. Tries to support that as a goal.

Q. Okay. And in the months of depooling, and I'm particularly looking at November of 2020 in Federal Order 30, there was 20 billion -- sorry -- 2 billion pounds of milk depooled from the order, which equated to almost $67 million withheld from the pool if all handlers were required to pay into the pool.

A. Okay.

Q. Okay. So for a Class I handler who has to pay that minimum -- that minimum blend price, they have to pay money into the pool, competing against manufacturers for that supply of milk. They are using premiums to help attract that milk to fluid use.

Would that -- would they be at a disadvantage for attracting that milk, knowing they have to pay into the Federal Order pooling system when manufacturers are not

required to do that?
A. I think I have already testified that that can be a problem. Depooling can create the issue of different prices, and why USDA tends to support ways to reduce that, if not eliminate it. But they only have certain tools that -- to be able to address that at this hearing.
Q. Should using the higher-of, which increases the Class I differential, that mover, adding more money into the pool, does that go beyond potentially what the original intent of the Act was? When you talk about highest use value, in the months where Class III prices are higher, does it go against that?
A. I think it actually supports it by addressing the issue we have talked about in terms of making sure that Class I value has the highest value in the market.
Q. But if the months of depooling, isn't the cheese market value higher based on the cost net, with price-net manufactured milk?
A. At times it can be, but the higher-of helps to drive that Class I price higher than the cheese value, if it's the higher-of.
Q. In the months of depooling, shouldn't that value of that depooled milk be returned to all producers?
A. I guess that's an equity issue that is not really the subject at this hearing. I sympathize with that issue, but it's not a proposal before this -- you know, this hearing, and has been handled on a regional basis in terms of pooling provisions.

Q. So would you -- by stating that, would you think that maybe that should be left up to the Market Administrator in each order to look at those pooling provisions?
A. They have some degree of latitude in terms of requirements, but it's also been through hearings in terms of, you know, significant changes.
MR. LAMERS: Okay. Thank you. No other questions. Thanks.
THE WITNESS: Thank you.
THE COURT: Mr. Lamers, how to you spell Mark?
MR. LAMERS: M-A-R-K.
THE COURT: Thank you.
Who else? Oh, I thought there would be more.
Ms. Taylor, any follow-up before redirect?
MS. TAYLOR: No.
THE COURT: Redirect.
MS. HANCOCK: Thank you, Your Honor.
REDIRECT EXAMINATION
BY MS. HANCOCK:
Q. Mr. Alexander, can you anticipate any time in the future where Class I supplies might be insufficient to supply the market?
A. Well, I think there's certainly conditions that would tend to change the tone and the supply/demand balance, and new plants can create that kind of a scenario.
Q. Do you know if in your area if there are any new

plants being contemplated that would serve the Class I market?

A. We have multiple plants either currently in construction or anticipated to be in construction in the near future. There's at least four that are -- that are that are in play.

One is HP Hood in Batavia. There's been an announced expansion there. That plant is actually relatively new to the market already.

There's also the Great Lakes expansion in the Southern tier in Western New York. They are doubling the size of that plant.

The -- there's a new plant that's being anticipated to be built in Rochester, New York. That's Fairlife. And so that's a sizeable new plant.

And then there's a smaller plant expansion. That's Wells Dairy, Dunkirk. It's ice cream.

Q. What was the last one? Say it --

A. That's Wells Dairy.

Q. Okay. And that's just the ones that you already know of that are either under construction or to start imminently?

A. Correct.

Q. And so that doesn't take into account anybody else in -- in this -- and this is all just within your Federal Order 1 market area?

A. That's all within Western New York.

Q. Okay. And then you also talked about -- I think when you were talking with Ms. Vulin about -- she was asking you about Class I supply and whether there were any issues in getting milk, and I think you had given an answer about, well, it depends on where and it depends on when.

I'm just wondering if you could elaborate on when those supply challenges occur with Class I.

A. Well, a classic one, and it's probably even more disruptive moving milk into the Southeast, but it's basically the first week of school opening, where the pipeline is dramatically tightened and milk has to move in anticipation of all the school milk that's going to be consumed, so that tends to have a significant draw on the market. So that -- that needs to be available at that point in time.

That's not the only time. There's certainly plenty of circumstances -- and we know these real well in Western New York where there's snow. Even just the forecast that there's going to be more than six inches, and we get an impact at the supermarket level in terms of milk orders.

And certainly some of the big impacts that we had during COVID and some of those situations where it really shortened up our supply availability dramatically in terms of, you know, how much milk we could move into a Class I plant and have it processed.

The situation in terms of Christmas is the other way around, where you basically lose those sales, well, you know, customers are doing other things, and plants tend to shut down, so we basically have a lot of milk back in our lap.

Same situation when we talked about schools opening, schools closing. Now all of a sudden there's a lot of milk that now has to be processed.

So you have to be -- you have to have ways in which to balance that milk supply, both going up and going down. So that's -- that's kind of just a fact of life.

In the Northeast, we have a fair bit of manufacturing, so there's availability of that manufacturing supply to some extent. But even there sometimes that supply is locked up in contract, so it's not necessarily always available.

However, when you look at some other markets like the Southeast, they are particularly tenuous in terms of their availability to supply. So those supply conditions can really change pretty dramatically.

Q. Okay.

MS. HANCOCK: Thank you.

I have no further questions, Your Honor. We would move at this time for admission of Exhibit 245.

THE COURT: Let me recognize the gentleman on the back row. Come to the mic and tell me why you raised your hand.

DR. BOZIC: Further cross.

THE COURT: I'll allow it. Please state your name.

DR. BOZIC: Marin Bozic, Edge Dairy Farm Cooperative. Further cross-examination prompted by redirect?
THE COURT: You may.

RECROSS-EXAMINATION

BY DR. BOZIC:
Q. Mr. Alexander, you mentioned, I believe you said four new fluid milk plants in the Northeast?
A. I mentioned four plants. Not all of them are fluid. One is actually a cheese plant, and the other is an ice cream plant.
Q. So two new fluid plants.
A. Yes.
Q. Are they being --
A. They are beverage, you know, fluid beverages.
Q. Are they being built because of an increase in fluid milk demand in the Northeast?
A. I suspect that there's been some demand in increase, yes.
Q. An aggregate increase in demand or demand -- or increase in demand for a particular type of milk beverage or milk products, fluid milk products that they would be producing?
A. I think that there would be a particular demand.
Q. Would it be rational to expect that if there is no increase in the aggregate demand, an increase in demand for some products, that there would be a reduction in demand for other products? For example, we've seen the

increase in sales of ESL milk, while at the same time we have seen many, many closures of HTST plants over the last few years.
A. Is that a question?
Q. Yes. Albeit a long one.
Would it be rational to assume that if there's no increase in aggregate demand, but there is an increase in demand for some products, that that would mean a reduction in demand for other products?
A. I guess I haven't done a study on that, but I guess that's a possible conclusion to come to.
Q. If there is no increase in aggregate demand, and if there are new plants being erected to supply, presumably ESL, not HTST, would that create a risk for your business model given that your buyers are primarily HTST business?
A. I -- first of all, I don't know that that's the case with them being my customer.
And, secondly, I don't know that that's necessarily a risk.
Q. Do you supply any ESL milk now?
A. No.
DR. BOZIC: No further questions.
THE COURT: Thank you.
Does that prompt any other questions, either from Ms. Taylor or on redirect?
No. All right.
You have moved the admission into evidence of

Exhibit 245.

Oh, did you --

MS. VULIN: I just wanted to also move admission of Exhibit 246 at this point.

THE COURT: All right. Very good. Thank you.

So let me ask first. Is there any objection to the admission into evidence of Exhibit 245?

There is none. Exhibit 245 is admitted into evidence.

(Exhibit Number 245 was received into evidence.)

THE COURT: Is there any objection to the admission into evidence of Exhibit 246?

There is none. Exhibit 246 is admitted into evidence.

(Exhibit Number 246 was received into evidence.)

THE COURT: All right. Let me see where we are.

First of all, can this witness step down?

Secondly, can Mr. Alexander be excused or might he be recalled?

MS. HANCOCK: Your Honor, we have not been making that delineation, but I believe that he'll be available at least for a period of time this week.

THE COURT: Very good. And let me see.

It's approximately 10:33. I think we had a break recently, so we can just go on to the next witness.

Who would that be?

MS. HANCOCK: Chris Hoeger.
THE COURT: Say that again?
MS. HANCOCK: Chris Hoeger. I would spell it, but he will in just a moment.
THE COURT: Yes. Thank you.
MS. HANCOCK: I don't know if you're getting copies of the exhibits. Do you want copies?
THE COURT: I have no idea what I have. I don't think I have them all. If you have an extra, I would be delighted.
Mr. Hoeger, would you state and spell your name, please?
THE WITNESS: Chris, C-H-R-I-S, Hoeger, H-O-E-G-E-R.
THE COURT: H-O-E-G-E-R?
THE WITNESS: Correct.
THE COURT: And have you testified previously in this proceeding?
THE WITNESS: Yes, I have.
THE COURT: You remain sworn.
THE WITNESS: Very good.
THE COURT: You may proceed.
MS. HANCOCK: Thank you.

CHRIS HOEGER,

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

DIRECT EXAMINATION

BY MS. HANCOCK:

Q. Mr. Hoeger, good morning.
Did you prepare Exhibit NMPF-33 in support of your testimony today?
A. Yes.
MS. HANCOCK: Your Honor, I believe we are at Exhibit 247, if we could mark this exhibit.
THE COURT: Yes. This shall be marked as Exhibit 247.
(Exhibit Number 247 was marked for identification.)
MS. HANCOCK: Thank you.
BY MS. HANCOCK:
Q. Mr. Hoeger, proceed with your testimony, please.
A. Yes.
Prairie Farms supports National Milk Producers (NMPF) proposal for restoring the higher-of for establishing Class I mover from original Federal Order Reform.
I'm going to skip the next two paragraphs because I have already read it in my previous testimony.
PF was part of the consensus of organizations that originally supported moving to the average-of the Class III and Class IV skim mover to set the Class I mover when it was presented by NMPF and IDFA in 2018. We were supportive of the move as we felt that we might see an increase in hedging activity from our customer base, whereas prior to the change to the average-of mover, our hedging on Class I products was non-existent. We felt

that our customers would be more active on hedging after changing to the new formula for price discovery.

Since 2018, we have seen many challenges with milk pricing for the producer community, not the least of which is the unexpected creation of disorderly marketing, especially with extreme price volatility. We have found several issues that have negatively affected the producer community, as well as milk processors.

Since going to the average-of price mover, several problems have become evident with this price mechanism as compared to the higher-of mover previously used:

1: Revenue to producers was significantly reduced without recovery. PF members were severely impacted due to the price volatility due to increased depooling of milk in the various multiple component pricing (MCP) orders, where they have farms and plants.

2: Class I prices meant to incentivize movement to fluid processors should have created more orderly marketing, instead they actually created marketing that is -- that is more disorderly.

Number 1, revenue to producers was significantly reduced without recovery.

Since the changing to the average-of in May of 2019, there have been more volatility in producer pricing due to additional depooling and creating disparity of producer pay prices. The incorporation of the average-of in the Class I formula has led to significant increase in depooling between the classes of milk.

Farms that are suppliers to a pool distributing plant do not have the ability to depool their milk. With the average-of formula, producers will fall into two groups, the haves and the have-nots, as there is always some depooling of either Class III or Class IV.

The average-of analysis shows that there is asymmetrical risk when the difference between Class III and Class IV advanced skim pricing factors is greater than $1.48 per hundredweight, as per Peter Vitaliano's testimony.

This asymmetric risk increases the probability of depooling, which negatively affects producers supplying to pool distributing plants. Pool distributing plants do not have the ability to depool, so these plants are required to take the pool price, while others can be can depool and take advantage of the price inversions.

This occurred in the fall of 2019, prior to the 2020 complications caused by COVID issues that were encountered in the later part of 2020 and early 2021. Those who could depool were able to avoid the price inversion, while others had to stay in the pool and absorb the impact of the increased Class III prices.

USDA recognized this became an issue and attempted to remedy the situation through Pandemic Market Volatility Assistance Program, better known as PMVAP. But those payments did not occur for some time after when producers had to endure the pricing problem, and those were unique circumstances that may not allow the USDA to provide such assistance again in the future should an increase in prices occur again.

PF dairy producers are appreciative of the support from the USDA through the PMVAP payments made in 2022 and 2023 for the changes to the cheese prices in part caused by the USDA's Food Box Program. However, those payments did not fully compensate all producers or as timely as it would have been under the higher-of Class I pricing formula.

Dairy producers want a pricing system that gives them market indicators at the time, and not payments received later from the taxpayers. In fact, many dairies producers were no longer in business when the PMVAP payments were distributed. The higher-of would compensate the producers at the time the milk is sold and supports moving in an over -- milk in an oversupply to its highest value use.

Disorderly marketing due to higher depooling.

Another issue generated from the average-of versus the higher-of is higher instances of depooling. This results when one of the manufacturing classes is higher than the average pool price. In 2022, 2023, PF experienced a situation where some of the closest milk supply to a Class I market became unavailable unless it received a premium due to the milk being utilized for a higher value, more distant market, providing a higher return. As such, that closer milk was not part of the pool because it was shipped to other locations outside of the pool.

When this situation occurs, it forced PF to secure milk supplies from further markets due to the financial inequities between classes. PF tried to secure milk to supply its plants that would have been less than 150 miles from the supply to the plants, but it was asked to pay a premium over the over-order premium to secure the milk and move this milk.

The supplier did not want the consequences of this milk being pooled and opted to sell the milk to a farther away market to secure the higher premium price and avoid the pool. This occurred when the spread between Class III and Class IV were larger than $1.48 per hundredweight and supply conditions in other markets.

These inefficiencies of swapping markets and driving up prices because of the desire to depool and capture higher market prices in other areas resulted in disorderly market conditions.

Due to this disorderly marketing, PF saw higher costs caused by moving milk around, which increased the food miles cost and added more environmental concerns from the transporting of milk a farther distance.

As shown in the chart below, since switching to the average-of, producer price differential has become larger and tended to be more negative more frequently when compared to the higher-of.

Data from Federal Milk Marketing Order (FMMO 32) during the six-year period prior to May 2019 revealed

27.36 of the months were associated with a negative PPD, averaging a negative $0.34 per hundredweight, and the four-year period since May 2019, shows a negative PPD in 37.36% of the months, with an average of a negative $2.85 per hundredweight.

PF supplies many types of large and small customers within retail, convenience store, QSR, and foodservice outlets. PF was supportive of the average-of price mover as we believed it would support our customers' ability to hedge more Class I product. This has not been the case.

Under the higher-of price mover, the only real fixed price contracts were done by schools. PF absorbed the risk of these fixed price arrangements, as it is a nominal part, or a small part, of our overall business. Since going to the average-of, we have not seen an increase in Class I fixed price sales agreements. Our fixed price sales agreements continue to be requested and utilized by the same customers prior to the change. If anything, we have more customers interested in fixed price agreements for Class II products.

PF has seen a decrease in the producer forward contracting with our members engaged in hedging risk management. Negative PPDs is a negative basis that dairy producers are unable to hedge or mitigate the risk. As shown below, the two farms that have hedged for many years as a way to manage their margins, are an example of what dairy producers received for a revenue stream.

Table 2 shows the various negative basis. The negative basis makes managing milk price risk considerably more difficult for dairy producers. The result is that dairy producers are not engaging in risk management tools like they did previously.

In summary, dairy producers have used risk management tools for decades to support their business and manage their margins. Basically, dairy producers have made sacrifices by taking on additional risk themselves and giving up a higher Class I price under the assumption processors would develop their own risk management tools for Class I. But processors have not done so. PF has not seen an increase in customers requesting Class I fixed price agreements after changing to the average-of Class I formula.

We need to return to the higher-of so dairy producers can have a reliable tool in their toolbox to manage their business without the need for inviting additional risk.

PF expresses its appreciation to the Secretary of Ag and the Dairy Division for holding this hearing. We strongly recommend the Secretary to adopt National Milk's (NMPF's) Proposal 13, return to the higher-of for the calculation of the Class I skim mover. This will promote orderly marketing of milk and ensure an adequate supply of milk for Class I operators to serve their markets.

Respectfully submitted, Chris Hoeger.

MS. HANCOCK: Thank you, Mr. Hoeger.

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

CROSS-EXAMINATION

BY MS. VULIN:

Q. Good morning, Mr. Hoeger. How are you?
A. Good morning. And you?
Q. Good. Thank you.
Ashley Vulin with the Milk Innovation Group.
You are here with Prairie Farms, correct?
A. Correct.
Q. And how many Class I plants does Prairie Farms have?
A. 30, including our joint venture plants, which we are the managing partner of.
Q. 3-0?
A. 3-0.
Q. And where are these plants located?
A. As stated, I guess that's the part of my testimony I didn't read, but it's from the Midwestern states, from the Canadian border, all the way down to the Gulf of Mexico, comprises in nine different states -- no, excuse me, more than that. 16 Midwestern states.
Q. And are all of them located in Federal Milk Marketing Orders?
A. No, not all of them. One of them is in a state order up in North Dakota.
Q. And are the remaining 29 all fully regulated?
A. Yes.

Q. None are partially regulated?
A. No. They are all fully regulated.
Q. And which orders are they pooled under?
A. We have six different Federal Orders that they are pooled under. Federal Order -- start at the bottom -- 30, 32, 33, 5, 6 -- no, excuse me -- 5, 7, and 126.
Q. I usually need the map.
A. I rattle off 5, 6, and 7 because that's just part of the Southeast, but we're not in Florida.
Q. That's okay. No problem. And I usually need the map to do that, so job well done.
Does Prairie Farms sell any branded Class I products?
A. Yes, we do.
Q. What is the breakdown between the branded products and the non-branded products, just roughly?
A. Hate to admit that, but I really don't know. But if I was to estimate, it's probably similar to Mr. Alexander's, it's probably 20 to 25% is branded.
Q. Is branded?
A. Branded, yes.
Q. And what do you consider to be Prairie Farms' most successful Class I product?
A. One that we have the toughest time and I guess it's, you know, limited production, is probably our iced coffee. And that -- I mean, overall it's probably our core group of gallons and half gallons that we offer to the consumer as a volume perspective.

Q. Sorry?
A. Gallons and half gallons of the various fat levels are probably our volume, you know, when you look at -- if you want to talk successful based on volume or uniqueness, I would say volume, it's the gallons and half gallons of our brand.
Q. And those are HTST milk?
A. Combination of both. We also have ESL operations. Two of those 30 plants are ESL. We do do, in the ESL operation -- or pints and quarts, so we have gotten national distribution on a lot of those.
Q. And what's the shelf life for your ESL products?
A. You are testing my memory there. I'm going to say 90 days. I'm not on the sales side, so apologize.
Q. An estimate works.
How many plants does Prairie Farms have that are not Class I?
A. We have a total of 50 plants, so that I would guess if I said 30, that would leave 20 that are non.
Q. And can you give me a summary of what types of products those plants sell?
A. Those are ice cream plants, cultured plants, cheese plants.
Q. And are those pooled? Do those plants pool their milk as well?
A. We pool them through the pool system, whether it be a pool silo -- you know, a supply plant or a pool silo. So we'd qualify that milk to be pooled.

Q. And has Prairie Farms ever, we call it depooled or not pooled milk for those plants?
A. Yes, we have. We did the depool during COVID.
Q. Why?
A. It was a very hot, contentious topic with our members. It's -- it's part of the -- allowed in the order. We were not able to depool near what probably others were, but we -- we were able to pool a little bit of our -- probably -- well, it was less than 10% of our total milk supply.
Q. You were able to depool 10%?
A. Yeah.
Q. Okay. And why did you depool that milk during the pandemic?
A. Because the market warranted, and the depooling rules, I mean, Class III was higher at the time.
Q. You say the "market warranted." You were able to return --
A. Well, I shouldn't say warranted, but, yeah. The -- we were able to return a higher value to our members.
Q. By depooling the milk?
A. Yeah. Or on the flip side, being -- we have also at certain times you have to depool if you want to remain competitive, because if that other part or other competitor of yours is depooling, then they have more margin dollars to be more aggressive with their pricing. So that necessarily means that just because we depooled we

were able to return those dollars to our members. We were also probably able to move cheese because we were able to remain competitive in the marketplace, because if your competitor's depooling, you need to react to the competitive natures.
Q. And do any of Prairie Farms plants use the split plant provision? Are you familiar with that?
A. We have a couple plants that -- that are -- as far as like, we -- we do not have any, that I'm aware of -- you know, a split plant, but we have a couple plants, I'll use our Fort Wayne plant as an example, that are highly heavy Class II, but yet it's a pooled distributing plant, so you are not able to depool that plant. Whereas, you are competing against other Class II operators that may have, if they are a full -- a full Class II plant that can depool, then again, you run into those competitive pressures.
Q. And for Prairie Farms' 50 plants, do all of those plants use owned supply milk?
A. No. We have always over our history strategically planned that we purchase about 20 to 30% of our milk supply from outside partners and supply partners.
Q. And does Prairie Farms then send any of its own milk to other plants, or is it fully utilized in your 50 plants?
A. We -- we -- because of logistic reasons, we have -- I'm going to say it's a half percent that go to, like, a few cheese plants, mainly sometimes on the weekend

or just logistically it makes sense.
Q. And when purchasing milk, how frequently do you, as -- and when I say "you," I mean Prairie Farms -- how frequently does Prairie Farms, as a purchaser, negotiate milk supply agreements with its non-cooperative member suppliers?
A. Typically it's annually. We do have a couple contracts that are longer than annual that were part of the -- some of the latest acquisitions that we have done.
Q. Do you have any contracts that are shorter than annually?
A. We have a lot of handshake agreements. And under that handshake agreement they know that -- and it's -- I mean, whether I want to say that it's not technically in an agreement, but I follow it up with an e-mail knowing that if we lose a customer, we may -- we will -- we will have to back off on our need or -- you know, need for supply.
Q. Okay. So the intent would be to keep them on as long as you could?
A. Yes. I mean, we -- we value them as partners, so we want to try to do the right thing and, you know, honor our agreements and take as much of their milk as we can. But the Class I is -- is an up-and-down market, too, because it -- it ebbs and flows every, hate to say it, every 48 hours it seems like some days, because the consumer doesn't buy on a consistent pattern.
Q. Uh-huh. And I -- I believe you were sitting in

earlier when I was talking to Mr. Alexander. I'm trying to get a sense of the time horizon. We have talked a lot during this portion of the proceeding about market signals --
A. Okay.
Q. -- and producers responding to market signals, and processors responding to market signals.
But from a producer perspective, if the market is telling them to do something different with their milk, either ramp up or ramp down production, what is the time horizon for responding to that market signal?
A. We typically have been told by our producers that it's four to six months for them to react in any significant way.
Now, if you want a -- a one -- you know, 1% increase, they could probably change their rations, change their culling practices, no different than Mr. Alexander indicated.
Q. Okay.
A. But if you really want to significantly add supply, they have -- they have shared with us that it's probably four to six months, if not even a little bit longer than that, depending if there's a need for infrastructure build out and so forth.
Q. And in your testimony you say that the problem with the average-of as the base Class I skim formula is that revenue to producers was significantly reduced without recovery.

Do you recall that?
A. Yes.
Q. And so are Federal Milk Marketing Orders price enhancement programs?
A. No. But they are -- they are there to as -- to provide a basis or a foundation of -- of kind of an equilibrium and balance the classes milk. That's -- that's the purpose of allowing Class I to be the -- you know, the highest price, because Class I is a little bit more -- unlike we have cheese plants, so we -- we could pretty well schedule our cheese plants -- I can schedule my cheese plants two weeks from now and it's going to be relatively the same volume.
But on a Class I, it ebbs and flows by the weeks and the days of the week, just due to the fact of the -- like I mentioned earlier, it's sometimes 48 hours that we -- we get our orders from our customers 48 hours in advance.
Q. And if -- if there are sufficient supplies of milk to meet fluid use, is there any reason why FMMOs should increase revenue to producers?
A. Well, it's a relative term, I guess, when you say that there is sufficient supplies. Yes, I wouldn't disagree that for the most part there are sufficient supplies. But we're also seeing that some milk that is closer, as I described in my testimony, that is close, and when it comes to even some things that Mr. Alexander indicated, to volatility within the Class I, a snowstorm

comes or something of that nature, that where there's a need for an increase, because some of the closer depooled or whatever milk that's going to a higher value is going away from a Class I plant, and so we're having to pool milk farther. And with the need for transportation, milk is traveling farther, which, hence, sometimes creates challenges to get production.

We have had -- we have had times where we have had to shift production from different plants and shift -- because the raw milk supply was there amongst our 30 plants versus getting it to probably the plant that we really needed it at.

Q. When you are talking about a snowstorm, setting a minimum price in Federal Milk Marketing Orders can't address supplies if there's a snowstorm for a weekend, correct?

A. No. Totally agree. But going back to, like I said in -- on page -- page 2 of my testimony, there is -- there is some milk that is less than a hundred miles from some of our plants, and we have tried to work out supply agreements with that company. And because they are a Class IV operator, all of '22 and '23, they have had no interest in even talking unless we pay them a significant premium. And so then, hence, we have to go farther away. And the farther you go away from the market to get -- to get your supply, the more risk that is involved. If you had the higher-of, that supplier has fully admitted that they would gladly entertain into an agreement or a

contract to supply us.
Q. So absent the higher-of, that supplier believes that it is more valuable for them to use their milk for Class IV purposes than Class I?
A. Right now it is. And if you look at, you know, even going back to what we have talked about the asymmetrical risk, 22 -- or excuse me, 14 out of last 21 months, in 2022 and 2023, there has been larger than that $1.48 difference. And so right now, that supplier has that feeling. If it flips, then maybe they will change. But right now, it doesn't appear that way.
Q. But you -- in your Class I plants, you have been able to get sufficient milk to meet your needs for fluid use, correct?
A. Not in all situations. We changed the way we did business. We actually did it in twofold situation.
A, we knew that we were not going to be able to get the supply in the three-week or four-week ramp-up with schools that just occurred here, so in two -- a couple of our markets we purposely, knowing that we're going to struggle to get supply, we moved and we went with an aseptic product, or even longer than extended shelf-life, because we also -- we have that co-manned for us. And so we distributed that to schools during the ramp-up period.
Q. Other than the school ramp-up period in the last year, have you had any trouble getting sufficient milk to your fluid plants?
A. We have had a few instances in the fall of the

year that have carried on, but it's just as purely a situation that we have gone to a much farther market to bring milk in.

Q. And earlier Ms. Taylor had asked a question of Mr. Alexander, how would you define orderly marketing? And I believe his response was that what goes into the pool reflects market value.

Would you agree with that statement?

A. That should be the goal.

Q. Okay. And you would agree with me that sometimes the market values milk for Class III over Class I, correct?

A. No different than the example that I said on the Class IV.

Q. And in that case, the pool should reflect that milk for Class III is more valuable than for Class I, correct?

A. It should. But the whole purpose of one of the foundations is -- for Class I is -- because, again, what I mentioned earlier, Class I is demanding, so it should -- that's why we view it should be the higher priced item, is because we don't take it consistently. We don't -- unlike manufacturing. We take it periodically in the sense of even during the week.

I mean, there's -- on the weekend we don't take milk as a -- as consistently as we do during the week. We always -- because of that whole 48-hour that I referenced, our biggest demand days are Tuesday, Wednesday, Thursday, because our plants are gearing up for production to deliver to our customers for the weekend, because that's when the vast majority of the consumers, from what we have gotten indication from our customers, shop.

Q. And so you believe that adopting the higher-of should disrupt those market signals to ensure that Class I remains at the highest price?

A. What do you mean by "disrupt market signals"?

Q. Well, so you agreed with me that the pool should reflect market value, and then you agreed with me that the market sometimes values Class III over Class I. But it is, as I understand it, your position that the Class I price should be always the highest price even if the market is not valuing Class I that way.

And so my question is, do you believe that the higher-of should be utilized in order to disrupt market signals in the pool to keep Class I above Classes III and IV?

A. But how do you -- I guess, again, how are you trying to say that the classes -- Class III -- if you are pricing the Class I off of the higher-of, then you would be the price the same as the Class III, correct?

Q. After, yes. Right? But now you are kind of getting in a circle where Class I is the highest because you're pegging Class I over the other classes. So that's why I started my question with what's going on in the market, right?

And so -- and --

A. But the Class III and Class IV are part of what makes up the Class I, whether you do the average-of or the higher-of.
Q. Uh-huh.
A. So if we are to say that we wanted Class I to ensure the highest value, then you would always price it on the higher-of versus the average-of.
Q. Okay. And I think that answers my question, but I'll circle back if I need to.
MS. TAYLOR: Excuse me, Judge Clifton, I do hate to interrupt, but it is 11:05 and I'm thinking the court reporter might need a second break, if this was an appropriate place to take it.
MS. VULIN: Sure.
THE COURT: It is. Very good.
Was ten minutes adequate last time?
Good. So it's now 11:06. Be back and ready to go at 11:16.
(Whereupon, a break was taken.)
THE COURT: Let's go back on record. We're back on record. It's 11:16.
Ms. Vulin, would you identify yourself again?
MS. VULIN: Thank you. Ashley Vulin with the Milk Innovation Group.
BY MS. VULIN:
Q. Just a couple of quick questions.
A. Sure.
Q. The couple instances you said where your plants

had issue attracting sufficient milk for fluid use, did you utilize any of the call provisions under any order?
A. Okay. Chip had asked me that in some of my original testimony. But there's not call provisions. Because ironically, I called Mr. Wilson that Monday after, because I was short 30 loads of milk, and in Order 32 there are no call provisions.
If you are aware of one, I'll take some milk on demand.
Q. Have you asked to change the performance standards in any of the orders?
A. In Order 32 we have not done any changes, and there were changes done in Order 30 within the last couple years.
Q. To raise the performance standards?
A. No, to -- to lower those.
Q. Okay. And you'd agree with me, if you are short on milk needed for fluid use, raising performance standards would be a pretty direct way to address that?
A. Correct.
Q. And then --
A. But that's one of multiple tools to do that. I mean, going to the higher-of is going to be one tool. Some of the other National Milk proposals to attract milk to the Class I, such as the price surface, which I know we'll be discussing later, are another tool. But that's why National Milk has come with a comprehensive package to address all of it in one big group.

Q. And you agree those are all national changes, correct?
A. Correct.
Q. Whereas performance standards could be changed on an order-by-order basis, correct?
A. Correct.
Q. And if you could go to page 3 of your testimony, please.
A. Sure.
Q. Now, this table you have in your testimony, I just want to make sure I understand the point here. The point being that during the higher-of prior to 2019, in FMMO 32, there was a negative PPD 27% of the time?
A. Correct.
Q. But after the adoption of the average-of plus the adjuster, there was a negative PPD 37% of the time.
Is that what you are showing here?
A. Correct.
Q. So an increase of 10% in negative PPDs after the adoption of the average-of?
A. But also the significant increase from $0.34 negative to $2.85.
Q. And what portion of this increase in depooling is caused by the base Class I skim price moving from the higher-of to the average-of versus other market factors?
A. The base class skim price, I'd have to go back and research that in further detail. All I did was build this graph from that. I don't have that data readily available

at my fingertips.
Q. Okay. So what you are showing here is there is correlation between negative PPDs and the shift to the average-of, but you don't know if there's actually causation?
A. Correct.
MS. VULIN: Nothing further. Thank you.
CROSS-EXAMINATION
BY MR. SJOSTROM:
Q. Good morning, Chris. How are you?
A. Good morning, Lucas.
Q. Lucas Sjostrom, Edge Dairy Farm Cooperative.
You heard my questions to the previous testifier, I presume, on risk management of farms and timing.
I just have one question.
A. Sure.
Q. Would you agree it's better for your farmers to know about pricing before the price happens, if that was available, for planning and risk management purposes? Would that be superior for your farmers than to know after the prices are announced and paid?
A. Are you talking versus advanced pricing?
Q. In general.
A. In general.
Q. Is it better to know for planning purposes, prices ahead of a month or after the month has already happened?
A. Well, I think they would honestly be like anything, if you knew in advance, that would be better

than always looking in the rearview mirror.
MR. SJOSTROM: That's all. No further questions. Thank you.

CROSS-EXAMINATION

BY MR. MILTNER:
Q. Ryan Miltner representing Select Milk Producers.
Good morning, Mr. Hoeger.
A. Good morning, Ryan.
Q. In your testimony, you -- under Item 2, so bottom of page 2, continuing on to page 3, you're describing some efforts by Prairie Farms to secure milk, and there was some questioning from, I think Ms. Vulin about this, but you were trying to attract additional milk to your plants.
And I did not hear, was that -- was that from another cooperative you were looking to purchase from?
A. Yes.
Q. Now, I want to talk about the price inversion that perhaps triggered that to occur.
That cooperative, they were making a rational economic decision for their members at that time, correct?
A. Yeah. I don't fault them for that. And they -- if they were wanting to help us out and serve the Class I market, they wanted the average-of along with any over-order premium, was still lower than what they were going to receive in the Class IV market, so it's a business decision. And I don't fault them for that.
Q. Yeah. And -- but your testimony, I think, is that the adoption of Proposal 13 would change that economic

decision perhaps for that cooperative and make it easier for Prairie Farms to make the most efficient and economically advantageous acquisition decisions; isn't that correct?
A. Correct. They have told me repeatedly that if it was the higher-of, that they would gladly sell us milk. Because economically, it would even be better for them, because it's a shorter distance for them to travel than where they are going currently. But even with the little bit further distance that they have to travel, it's still, under the current program, more economically advantageous for them to go to the Class IV plant.
Q. So it's only economically efficient because of the current Class I mover?
A. Correct.
Q. And it is environmentally inefficient because of the additional hauling distance, correct?
A. We -- yes. And there's -- I mean, that's a whole Pandora's box, because there's a lot of milk that moves around. But in the simplest form, with all the environmentally going green programs that we're challenged to try to do, this would be an easy fix.
Q. Well, let's take the environmental impacts out of it, and everything that comes with that.
It's logistically inefficient, correct?
A. More importantly, it is logistically inefficient and presents less challenges. Because any time you move milk farther, you run the risk of disruption of supply.

Q. Would you characterize that as an uneconomic movement of milk?
A. Yes, because you are adding costs into a system that has to be recovered in one shape or form.
Q. Now, there are a couple of other proposals which we haven't heard yet, alternatives to moving to the higher-of, which I would characterize as modifications to the average-of.
A. Yes.
Q. Are you generally aware of those proposals?
A. Yeah. And when, as being part of the National Milk task force, we looked at six different proposals, if I remember -- for sure six, maybe even seven different proposals, whether it be the higher-of or the average-of plus a different adder than the $0.74. We went to even looking at a Class III Plus an adder, whatever the case may be. And we always resorted back to the higher-of.
And the interesting thing was, was even in our meetings when we were discussing it, we always kept comparing it to the higher-of. And even if you look at some of the other testimonies, they are always comparing it to the higher-of.
And, again, with some of those lookback periods, the higher-of is what compensates the dairy producer at the time of sale. All those other programs resort back to compensating them in the future. And if that dairy producer isn't in business, he's missing out on the compensation.

Q. And to the point you raise in your statement, do you think that tweaking the average-of mechanism would address the issue Prairie Farms has experienced with getting milk in from its closest sources?

A. It might, depending on that -- on that adder, because of the size of the adder. Because, again, it comes down to what we just talked about. It's an economic decision. The current Class IV co-op that I was referencing in page 2 of my testimony, if that adder was high enough, it may incent that -- that co-op to look at going to Class I. But looking at some of those other testimonies -- or not testimonies, excuse me -- proposals, that's -- that's always a lookback, so it's a moving target. So is it on this year and off next year? I mean, that -- that to me looks like disorderly marketing.

Q. And there were also some questions asked of you trying to compare the value of milk when the Class III price, for instance, exceeded that of Class I.

Do you recall some of those questions?

A. Yes.

Q. Now, I want you to think about the Class III price announced for any specific month, and the -- and in the Class I price announced for any specific month. Even though those prices apply to the same calendar month, are they pricing the same milk?

A. No. Because Class I is in the -- what I will call the here and now, and Class III is cheese, and that is -- unless it's going to be cheddar, but there's a lot of

other cheese made out in the industry as our -- some of our plants make other variety of cheeses, that Class III is for future month's sales.
Q. And so in your experience, is it -- is it -- is it appropriate to look at the announced Class I and Class III prices for a calendar month and use that to compare the value of milk?
A. No, I do not.
Q. On page 4 of your statement you provide some comparisons --
A. Uh-huh.
Q. -- for producers that have hedged their milk.
Is the negative PPD perhaps the biggest open risk to a producer who is trying to actually manage their risk?
A. Yeah. Because it's an unknown until after the fact. You really don't know what that's going to be. I mean, when you are -- when you are doing a forward contracting program or a risk management program, your anticipation is that that PPD will be minimal, positive, or negative, as indicated in the previous chart from, you know, prior to going to the average-of. That producer could go through a hedging program, and yeah, it may be negative $0.40 -- $0.30, $0.40, or it could be positive $0.30 or $0.40.
But when you get into thinking you have locked in a price -- the one producer that I -- farm B -- and I'll honest, I thought that this -- this situation was going to put them out of business, because in May -- April and May

of 2020, when the COVID pandemic had hit, they went out and actually hedged November milk, because at that time, they made a business decision, saying, okay, $15.91 milk is pretty attractive compared to milk right now being $10, $11. So they hedged.

Well, then because of some of the unforeseen causationable reference that, of the Food Box Programs, they ended up going home with about 8 bucks a hundredweight, which I thought for sure was going to put them out of business. But they have got -- they had a strong balance sheet that they were able to withstand that.

And you wouldn't anticipate that. I mean, in a normal hedging, what they have done for decades, and this producer, A and B, have been hedging on a forward contracting program for -- for well over a decade, and they were able to always hedge. And, okay, yeah, I know I got $15.91, the PPD is generally going to be slightly positive or slightly negative, so they are still going to, for the most part, go home and bank, you know, $15.50 to $16.50 is a lot of their anticipation.

Q. And longer ago than I care to state on the record, there was a -- there was a hearing on depooling in the Central order, and the witness from Prairie Farms at the time said, since we have diversions of surplus milk to standalone manufacturing plants, we depool when it's advantageous. Although we do this, we do not feel that doing so is in the best interest of the Federal Order.

Is that still a pretty good statement of Prairie Farms' position on the issue?

A. Yes. If I was to take a survey of our members and that they wholeheartedly are against depooling because they feel that we should be all -- for the most part, as much as possible, be part of the pool and share in those efforts.

Q. And yet as a representative, and perhaps even a fiduciary for your members, you have an obligation to maximize their income within the bounds of the regulations, don't you?

A. I use my term in the office that it's like going to your buddy's house to play poker. And if the rule of the -- if he has house rules, if you're not going to play by house rules, you're probably not going to be in the poker game long.

So, again, unfortunately, if depooling is part of it, no different than I testified earlier on some of the other cross, we did depool milk in 2020 and 2021. We did that because, if our competition is also depooling milk, another cheese operator, and they take that lower cheese price because they take some of those dollars that they don't have to pay into the pool in a form of lower price, then we're going to be competitively at a disadvantage price-wise, so we need depool. Not necessarily all those dollars get returned to our dairy producers, but they a lot of times help generate or assist in maintaining or growing sales.

Q. And just to be clear, you believe that adoption of Proposal 13 will help to reduce the instances where it's economically advantageous to depool milk.
A. Correct.
MR. MILTNER: Thank you.

CROSS-EXAMINATION

BY DR. BOZIC:
Q. Marin Bozic for Edge Dairy Farm Cooperative.
Good morning, Chris.
A. Good morning, Marin.
Q. Are you aware that Brian Henrichs was asked last week by Mr. Miltner whether he would support removing advanced pricing?
A. I will say that I was here that day, but that exact question, I don't really recall that answer. So I -- I -- I don't recall for sure the -- want to have the court reporter replay it, I am fine, and I could help answer a question if there's a question there.
Q. She'll make a voodoo doll of us if we ask her.
I'm not sure what's the appropriate way to ask the follow-up question given that we cannot decide --
A. I'm sorry, I mean it's two weeks ago, and there's -- there's been a lot going on.
Q. No, I understand. I understand. I don't think that you were trying to be evasive.
But could you think of any reason why your producers may, in fact, not oppose removal of advanced pricing?

A. I think our producers would have to be very educated on it, because, in my mind, no different than Mr. Alexander expressed, what -- if you get rid of advanced pricing, what are you going to replace it with? And I know you had mentioned in questions with him about some type of Class I futures contract.

But in that same breath, then how do, on a day-to-day application -- because we pay 668 dairy farms every day, how do we pay them, and how does the Market Administrators settle up the pool? Because whether it's advanced pricing or a futures contract, you are still going to square up to something.

Q. Right.

A. And so I don't know if getting rid of advanced pricing, if your question is getting rid of advanced pricing is going to rid of negative PPDs.

Q. I would not stipulate that it would.

A. Okay.

Q. I would -- yeah. I will have to reserve explanation for my testimony, so I don't testify from here when I'm supposed to cross-examine you.

But would it be fair to say that removing advanced price -- I understand that you have other concerns noted, but would it be fair to say that removing advanced pricing would also help reduce depooling?

A. Again, I don't know how that possibly will, because you are going to have to set a standard.

One of the other concerns I would have with eliminating advanced pricing is that some of our customers require that we provide the month prior -- the advanced price, we -- we -- they require, because they want to audit us on movement, so they -- we have to provide the previous month's mover with the new advanced mover coming, because they -- I mean, it's not to say they cannot do that on a -- on a Class I futures contract, but that's some of the day-to-day stuff that we have to manage through.

Q. So the three proposals that are noticed for the hearing would -- so that would be Edge's proposal Class III Plus, the higher-of without the advanced, as well as the Farm Bureau's proposal, three proposals that are noticed, all three of them would settle Class I on the announced prices in various ways, but all three of them would settle on announced pricing.

So, again, setting aside merits or demerits in your opinion of those proposals, my specific question is, is that if there is no impact of rally on negative PPD, wouldn't that reduce your incentive to, for example, occasionally depool your cheese assets?

A. Well, to go back, though, to your original statement of, if you settled to the class prices, how are you going to price to your customer if your customer is wanting some type of -- as Mr. Alexander stated, too, and I would agree with his statement -- that our customers prefer some type of uniform class price that's announced in advance, A, so they can set their retails. Now,

Class I futures could possibly do that.
        But it's announced by the government, the advanced price, so that gives them a comfort level of some type of -- that everyone is going to be held or charged some similar cost standard.
    Q.   Okay.
    A.   Whereas, if you are doing a futures price, we -- we all know how the futures price, whether it be Class III, Class IV, and the -- possibly this new Class I, depending on how the liquidity is, that could be very volatile.
    Q.   I understand that you find issues with the proposal --
    A.   Yes.
    Q.   -- but if we could -- I think that, you know, one of the concepts of cross-examination is that you ask a pointed question and try to get a pointed answer, right?
    A.   Please repeat your pointed question, and I'll give you that pointed answer.
    Q.   My pointed question is, would removing advanced pricing, so would settling pool obligations of Class I handlers based on announced prices, would that reduce depooling?
    A.   I'd honestly have to sit down and do some analysis in that.
    Q.   Well, so maybe we can -- so you are seated, I'm standing, let's do the analysis on the fly.
        So let's say that the price for cheese goes up by

$0.50 between the 23rd of the prior month and the end of the current month. Right? So we have a Food Box Program or something like that. There's a massive rally in cheese.

A. Uh-huh.

Q. Now, suddenly on your cheese assets, you're not drawing from the pool, you are paying to the pool because of that rally.

A. Correct. That's causation that would cause that to...

Q. Right. So would it then be fair to state that if that rally did not cause the discrepancy between the advanced price for protein and the announced price for protein, that on its own, there would be other reasons why you may want to depool, but on its own, that would reduce your incentive to depool the cheese plants?

A. Possibly. But, again, I -- how are you going to settle the pool when the Class III wouldn't be -- there wouldn't be -- if there was that dramatic jump from again when that was set?

Q. Well, so if you are selling Class I milk on announced, then how much you have to pay to the pool -- in quotation marks, because there's a more technical way to say that, the PSF -- but the amount that you would have to pay to the pool would be based on the -- in the context of Proposal 17 and 18, on the higher-of Class III and Class IV announced skim milk price.

We can have a separate debate on challenges,

logistical challenges that would cause you and your relationship with your customers, but my specific question is on depooling.
A. Sure. But, again, it's all kind of -- because if you are going to charge your customer one price, whether on Class III future --
Q. Right.
A. -- and that Class I future is a combination of either the higher-of III or IV or the average-of, whatever the Department eventually settles on, and then that dramatically increases, how are you going to pay your -- I guess I'm trying to understand how -- and I don't mean to cross-examine you on yours but --
Q. As long as I can stand.
A. I want to make sure I can directly answer your original question.
Q. Am I permitted, your Honor?
THE COURT: You are doing very well, both of you.
DR. BOZIC: Okay. Should I be sworn in?
BY DR. BOZIC:
Q. Well, one way to do that -- and, again, you know, I think the liquidity is a fair concern. But one way for -- for that would be, that if you set the price to your customers on the 23rd of prior month based on whatever the futures have been on that day, or some period prior to that day, so now you know exactly how much your customer is going to pay to you.
And then if in addition to that, if you were to

buy Class I futures as Prairie Farms, then if there's a rally between the 23rd of the prior month and the end of the current month, you would have hedging gains, so that the total revenue that you as a company achieve on that Class I sale, is a sum of what your customer committed to pay to you on the 23rd of prior month and the hedging gains that you have on the Class I futures. So your total revenue would actually match the Class I mover.

A. I -- I can understand where you are. But with our margins being -- that -- that's a lot of extra trading activity, right or wrong, that will add cost to the product. And I --

Q. I don't dispute that. So let's say that that cost is, let's say, $0.07 a hundredweight, you know --

A. Which is $0.06 of a cent per gallon, and on some -- some bid -- bid, or RFP as they call them nowadays from what I understand from my sales team, that's razor -- we get down to that level.

Q. I understand. So, you know, in that context, if AMS were also to recognize that then say, well, we will also increase the Class I differential by $0.07 to compensate for the higher trading costs, then you would be made whole, correct?

A. And I -- I'm sure from what we have gotten for general feedback from our customer base, if it's transparent and a part of some Market Administrator announcement, that cost, because then they know that's being uniformly, that probably would be accepted.

Q. I -- I did -- I did contemplate that, but I don't mean to be cagy, but I think it is more appropriate if I cover that in my direct testimony, which may happen later today or tomorrow, and then I'm happy to visit again as appropriate.
Okay. Now, could we also agree -- so in your testimony you state that "negative basis makes managing milk price considerably more difficult for dairy producers," and you define negative basis in terms of PPD on the previous page.
A. So that is feedback, yes, that I have heard from several of our dairy producers.
Q. Yeah. And I don't dispute that, even though some of the other witnesses from National Milk would consider equating PPD with basis to be problematic.
So -- so given your testimony, would it be fair to say that removing advantaged pricing would help producer risk management -- and, again, you may want to educate them that they may lose money on returns at the end of the year because your margins would be lower, etcetera.
But just focusing on producer risk management, would it be fair to say that removing advanced pricing would simplify producer risk management?
A. It probably would simplify, but I think the devil will be in the details to make sure that they clearly understand, because it would be a real education process.
Q. Sure.
A. And I have seen in the ten-plus years of just

working with dairy producers, there are -- it's no different than what we went through in explaining negative PPDs, just in general, not necessarily the negative basis.
Q. Right. Right.
A. I could explain it six times, six different ways to the same producer, and some are still not going to comprehend, because they still have the opinion that it's money that was taken from them.
Q. But that only goes to reinforce the fact that simplicity does matter, right? The more we can simplify, the more risk management will take place.
A. Uh-huh.
Q. Now --
THE COURT: Did you want a response to what you just said?
DR. BOZIC: Would you agree with that statement?
THE WITNESS: Yes.
DR. BOZIC: Okay. Thank you, your Honor.
THE WITNESS: Sorry, your Honor.
DR. BOZIC: Your Honor, I'm actually an economist, not an attorney, so I probably will make more such basic mistakes.
BY DR. BOZIC:
Q. Would you also -- so most -- you said, I believe in the cross that -- or direct, that you have some 30 fluid milk plants?
A. Uh-huh.
Q. How many of those do ESL products?

A.   Two of them.
Q.   Do you envision going forward that a larger share of your portfolio would be -- or a growing share of your portfolio would be ESL?
A.   That tends to be where the growth has been --
Q.   And if --
A.   -- in our operations.
Q.   I apologize, I didn't mean to interrupt.
A.   You haven't gotten slapped yet for talking too fast, so you're doing well.
Q.   So -- and ESL is more storable than HTST, correct?
A.   Correct.
Q.   So in that context, wouldn't it be reasonable to assume that ESL will open new ways to compete, even if -- even if we hope -- go back to the higher-of and nobody does risk management?
What I mean by that, is that as long as there's a seasonality in manufacturing prices, there could be some saying, well, maybe we made the products when the price is cheap and then offer some sort of --
A.   With our ESL, like I said, we're -- I'd answered in previous testimony, I believe it's about 90 days, no more than 120 that we put on for shelf life. You're -- typically if you are going to do what you are referencing, like some excess production to carry for the high demand periods, I -- I would be concerned with still running into code date issues in that, because your high supply versus high demand, Christmas -- well, high demand is always

going to be in the fall of the year --
Q. Sure.
A. -- leading before Christmas, and then after Christmas into the spring flush, that tends to be your higher supply, and that's going to be more than that 90 to 120 days. So I don't know if we could really -- we wouldn't be able to justify making that production ahead.
Q. But -- fair point. Unless there is further advances in computer technology or process that would extend the code date.
A. Sure. Sure.
Q. But would it also be fair to say that if anybody is going to start hedging in Class I space, that it's more likely to be an ESL player than an HTST player?
A. Correct. And when it comes to Class I, like I had stated in my testimony, we do not have any Class I being hedged. And then we do have a lot of Class II, and that continues to grow. And there's a -- there's a large -- one of the largest in the U.S., ESL operators that I have served on multiple committees with on IDFA and, =when we were a member of, and also several other dairy organizations, him and I had a conversation back this spring in February of this year, when we were at an ADPI board meeting, that we were talking about the make fee and, obviously, the differences between National Milk and IDFA.
Well, we also got in talking about other some of the other proposals that National Milk was proposing. And

I -- I had asked him point, does he do a lot of Class I hedging on the ESL side, and he stated, no, none. And he says all of his hedging that he does on the ESL side is on the Class II side.
Q. That was a statement reflecting his experience to date, not his long-term plans; is that correct?
A. Correct. But I don't think his long-term plans have changed since six months ago.
Q. What I'm trying to say is, and I think you indicated this earlier, is that it took a long time for dairy producers to pick up hedging after the tools became available for them to do so.
Would that be fair to say?
A. Well, our dairy producers?
Q. For dairy producers.
A. Our dairy producers have been -- I mean, this goes back to, I mean, prior to myself even being with Prairie Farms, when I was at Swiss Valley, we started hedging our forward contracting programs back with them back in the '90s, and our dairy producers have been actively engaged in that. But some of those same -- these two dairy producers are Legacy and Swiss Valley that came to Prairie Farms that have slow -- or done less since...
Q. Would it be fair to say that your volume on those forward-pricing programs four years since the date when you first offered it, is not -- was not as robust as ten years after you started offering it? Did it grow over time, in other words?

A. I'd have to go back and look at the records, but that's probably a fair statement.
Q. Where I'm going with this is that people may say, well, five years and a billion dollars later we are ready to be done with this experiment. But the whole truth would also have to account for the -- you know, how the risk management would evolve further, not only what happened to date.
Would that be fair to say?
A. I guess can you repeat your question?
Q. I'll rephrase it.
A. Rephrase.
Q. It -- it takes a long time for anybody to develop a risk management program, and just based on the amount of hedging done to date, we cannot fully predict whether there will be growth or not going forward.
Would that be fair to say?
A. Yeah. Because, I mean, we have currently customers that -- and it's not Class I, but it's -- whether it be cheese or butter or other products, that they Monday morning -- I call it Monday-morning-quarterback themselves.
And I have to be perfectly honest, until the butter price recently took off here, I would have thought that we would have had this situation where I had seen it over the years, that someone will go in, the commodity that they hedged went down -- and you have had to see this in your hedging career -- that the next year they feel

they -- no different than dairy producers feel they left out with the negative PPD, or lost out, they feel they left out -- lost out on the hedge, and then they don't, and then they regret it because the market --
Q. It's a bit of a yo-yo, right?
A. Yes. But overall, risk management continues to become more and more part of the business.
Q. So one of the earlier witnesses for National Milk made a fairly bold statement that risk management for fluid milk processors under higher-of is no more difficult than risk management under the average-of.
Is that the view that you also subscribe to?
A. Well, if you want to go to the OTC market, the traders, I'll call them the traders out there, can get very creative in creating a Class I, whether it be under the higher-of or the average-of.
Looking at it from a simplistic form, as you mentioned, it would be -- it -- it would be easier probably to do because you have to get into a lot more of analysis to maybe doing multiple contracts versus two contracts.
Q. So just to make sure the record is clear. Did you say that it would be easier to do under OTC or easier to do under the average-of and CME?
A. Well, I guess I'm probably talking in the sense that, in the simplest form, it's easier to do the average-of because you have got two contracts, which I think we both would agree on that.

Q. Sure. Yeah.
A. When you get to the higher-of, then you are still dealing with multiple contracts, but then you are getting into, are you buying or selling versus just flat out whether you want to go long or short on the average-of.
Q. So the higher-of -- other benefits notwithstanding, the higher-of is more complicated for fluid milk processors?
A. But in IV, like I reiterated in my testimony, I mean, we have done this for four years, and we have had no interest in even -- I don't -- I was just with a large QSR customer here recently, and they buy a lot of Class II. And we have been doing -- we started a hedging program with them in the last three years on a lot of Class II product, and we've been doing -- again, as we both know, hedging is really the insurance policy to keep your prices stable.
They have not -- they also buy a tremendous amount of fluid milk in the half pints, pint cartons, and if anyone is going to be more interested, in my mind, of trying to have a stable price -- because they can't change their menu every month, like you -- like, per se, in the retail side. They really have that probably more of a challenge. So if they were going to be interested in hedging, I would think they would also be very interested in their Class I. But they have -- they don't have any interest in that.
Q. So if your Honor will allow me, I would like to

ask for personal advice from Mr. Hoeger.
I have a four-year-old son. He -- he knows about half the letters. But I have given him enough time to learn the entire alphabet. Do you think I should give up?
A. No.
Q. Yeah. But do you think we should give up on fluid milk processors just because they don't know how --
A. No, I don't think we should give up. But also going back to this QSR restaurant, they have a very robust that they do hedging on a lot of other commodity groups, so I don't necessarily think that's a fair comparison, because we're already doing a lot on the Class II. And we have even discussed with them about it whether they want to go to the Class I, and they have not had any interest.
Q. Okay. I will -- thank you for answering that.
Just to close the loop on the OTC --
A. Uh-huh.
Q. -- I agree with you that hedging Class I is possible under higher-of through the OTC. But wouldn't it be fair to say that -- you stated that even if it costs you as little as $0.06, if we were to remove advanced pricing, that could eat up your entire profit margin, so it's technically feasible but cost prohibitive.
Could it also be the case that OTC for Class I, while technically feasible, is indeed cost prohibitive under the higher-of?
A. It all depends. Because I know of some OTC, and we use some OTC markets, and there are some that are more

focused on Class IV and -- and there always seems to be a decent amount of liquidity on Class III side. Then sometimes liquidity concerns is on Class IV, but we have found some OTC handlers or markets that they -- they seem readily available and willing to do some of those things if we needed or wanted to.

Q. I will agree with you the cost of the OTC products are not -- offers are not uniform across everything they do. They differ based on how soon they can offset their risk at their warehousing.

A. Yeah. I mean, we have had some OTC that actually are -- have been willing to take less than what the -- per se the Class IV, so that offsets any of that additional cost that possibly would be there.

Q. Right. Right. Going back to the depooling and the average-of. In your opinion, the depooling that we have seen in 2020 and 2022, would it have happened if we had higher-of approach since 2020 or since 2019?

A. There's still -- because of the causation of what caused, there still would have been some depooling, because it was to traumatic.

Q. The spread was traumatic?

A. The spread.

But in the same breath, if you go back to November of 2019, that was the negative $3 in Order 30. So that depooling wasn't necessarily caused by the USDA Food Box Program or COVID-related issues. So I mean, that depooling still would have occurred because there was a

dramatic movement upward in Class III.
Q. Have you done any research or are you familiar with any research that would quantify how much depooling would have happened if we had higher-of?
A. No. But I'm sure you have a document.
Q. I'm working on it. Thank you.
DR. BOZIC: That's all the questions I have.
MR. LAMERS: Mark Lamers, Lamers Dairy.

CROSS-EXAMINATION

BY MR. LAMERS:
Q. Mr. Hoeger, just a quick question.
You would agree that Marketing Agreement Act and any changes have to be in the public's best interest, correct?
A. Correct. That's the goal.
Q. Okay. And in talking about the higher-of the Class III or Class IV, there's times when you can see, particularly Class IV price, being almost $3 or $4 a hundredweight higher. And I was particularly looking at the month of June this past year.
A. June and July have been, yes.
Q. Okay. And if we attach Class I differentials to that higher-of in that particular month, isn't that artificially raising the price to the consumer?
A. What -- what Class I differential? The current ones?
Q. Any Class I differential in that, when you use the higher-of --

A.   -- that Class I --
Q.   -- when you have the higher-of, and let's say Class IV is $3 to $4 higher than the Class III price, the question was, isn't that artificially increasing the cost of milk to producers -- I mean, I'm sorry -- to the consumer?
A.   That is raising the Class I differential; though, is to also help move milk and -- to the Southeast, because that's the purpose of the Class I differential. And that -- but on the higher-of, whether it would have been before or now, that Class I differential hasn't changed at this point in time.
Q.   Right.
A.   So that really hasn't changed what the impact of the -- whether it would have been in 2018 or going forward, that still would have had the same impact.
Q.   The Class I mover is attached to the higher -- if you are talking about the higher-of, it's attached to that?
A.   Correct.
Q.   Okay. So in Federal Order 30, Class IV is about half a percent of the milk on the market.
Do you think it's appropriate using the higher-of in that market, particularly if you see that high of a spread?
A.   Well, Order 30 is a unique order because it has such a high concentration of Class III and such a low Class I utilization. But this is a national hearing, so

this isn't addressing just Order 30 challenges.
We need to look at it as a whole, that it's a national to draw that. So if setting the Class I on the higher-of, which would be to your point, Class IV, that will also draw the milk from those high -- from those high concentration orders to the orders that need.
Q. Do you know of milk in the Midwest moving down to the Southeast market?
A. We move some ourselves. We also pull a fair amount of milk from Wisconsin, as much as we can attract. But we have also now had to start pulling milk out of Kansas into the St. Louis market.
MR. LAMERS: Thank you. No further questions.
MS. TAYLOR: Might we take our lunch break now?
THE COURT: And do you -- you will have some questions when we come back?
MS. TAYLOR: Yes, we will.
THE COURT: Good. So it's 12:05. Please be back and ready to go at 1:05. Thank you.
(The lunch recess took place.)
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MONDAY, SEPTEMBER 25, 2023 - - AFTERNOON SESSION
THE COURT: Let's go back on the record.
All right. We're back on the record. It is approximately 1:05 p.m. The witness is ready, and we will resume any further examination questions.
Who would like to begin, someone from AMS or someone else?
All right. We'll proceed with AMS.
MS. TAYLOR: Good afternoon.
THE WITNESS: Good afternoon, Erin.
CROSS-EXAMINATION
BY MS. TAYLOR:
Q. Good afternoon. Just a couple quick questions for you.
I want to go through, you discussed the two problems that were evident in moving to the average-of. And for the first one, under revenue to producers, which was significantly reduced without recovery, on the bottom sentence of that first paragraph reads, "Those who could depool were able to avoid the price inversion, while others had to stay in the pool and absorb the impact of the increased Class III price."
So my first question is, can you just elaborate when you say "avoid the price inversion," what that means.
A. Well, from the -- what created the negative PPD would have been, obviously, the Class III was set with advanced pricing, and then the inversion between III and IV, III took off, which, then, hence generated -- the

Class III producers could depool, whereas our producers, who are primarily Class I, could not depool.
Q. Okay. So avoiding a price inversion is depooling and not having the negative PPD impact those producers?
A. Correct.
Q. Okay. And then my second question was the "absorb the impact," "while others had to stay in the pool and absorb the impact."
And from your first definition, that is those processors that couldn't depool, and so the producers were impacted by the negative PPD?
A. Correct.
Q. Okay. Under the second one, "disorderly marketing due to higher depooling," you discuss where you -- you discussed in your direct and on cross the situation where some of the closest milk supply was unavailable and you had to go farther out to get milk.
A. Correct.
Q. We have had -- we have had price inversions in the past. So did that not happen in those instances as well? I'm just trying to get for the record why it's different.
A. Under the higher-of, those price inversions were one or two month. But in the current environment that we have been under, and no different than I mentioned as part of my testimony -- or part of our cross, was even taking, as an example, 2022 to 2023, even if we count October, which was just announced last week, 14 out of those 22 months there's been that asymmetrical risk of Class IV

is higher than the Class III. And so that -- when it seems to be that ongoing, a lot of operators have made the decision to depool for an extended period of time versus maybe only being a shorter-term period.
Q. On that next page, on page 3, when you talk about how the spread between III and IV, when this occurs, so you are talking about your situation where milk wasn't going to Class I and you had to go further out to get it. And you said, "This occurs when the spread between III and IV was larger than $1.48."
And so I wanted to clarify if this occurred on more than one occasion. I think your example was you had an occasion, but your experience is that was more than once?
A. Yes.
Q. Okay. And then you -- the second part of that sentence, "versus when the spread was larger than $1.48 and supply conditions in other markets."
Can you elaborate what that means, when the supply conditions that are in other markets? Are you talking about in III, IV markets specifically?
A. Yes. Depending on the demand of some other -- of those other markets over the surrounding markets, it's -- it's prohibited to us to secure a, I guess -- we try to get the closest milk always to the closest plant. That's always been a fundamental principle in that.
So depending on, A, the pooling obligations of that party, if they want to pool or not pool. And then

also depending on the demand of even the next -- we'll call it the next potential supplier in line, if they have a shortfall on their -- whatever commodity they are making, they may have been unwilling to supply. And a third issue, what kind of ties into this more so is, there are some -- some milk that is -- as an example, Order 30 that is supplying Order 33, and if I needed an Order 32, because of that constraint, they don't want to qualify it on 32 when they already have it on Order 33 qualification.

Q. Uh-huh. So you used the word "unwilling," and that brought me to my next question. Because you did get questions from multiple people on whether there is a sufficient supply of milk for Class I already.

And is the problem a sufficient supply of milk, so not enough milk production, or is the problem a willingness for that production to go to where --

A. I would say it's more of a willingness due to economic decisions that are being made, no different than Mr. Miltner, you know, pointed out in the one -- one example, it's business. And no different than some cheese manufacturers or to Class IV or butter or whatever commodity you are making, they are gearing their plants to operate at a certain efficiency level, and sometimes they are not going to lower to serve the Class I, just -- just because they are nice guys. It's an economic decision. They have done the analysis to understand that their cost margins are that tight, that they have got to run -- they've got to run full, as an example.

Q. Okay. So on the bottom of page 3 you talk about hedging and risk management. And so Prairie Farms, despite having numerous Class I plants, does not hedge its Class I?
A. No.
Q. Can I ask what -- why doesn't -- what are the considerations that Prairie Farms looks at to make that decision that you didn't want to use that tool?
A. For ourselves, for our branded product, is I'm assuming the question is directed at?
Q. Sure.
A. I walked into that question, didn't I?
Part of it is the correlation between -- we -- we try to price our branded product as a correlation of the private label that we do, because they are going to be on the shelf together. So I get a lot of things to do in my day job, regular job, but one of the things is trying to price forecast. And if I give my sales team the wrong forecast and all of a sudden we want a $0.50 per gallon difference between -- and I'm using a theoretical number -- between our brand and the private label, because our sales team knows -- sorry, stepped away from the mic a little bit -- that we'll get -- we'll hit our targeted sales goals.
But if I go out and tell them, hey, let's lock in because I -- I think the market is going up, well, it's like I tell our dairy producers a lot of times when they ask me for a price forecast, you know, my price forecast

is only as good as the next five minutes, because it's like the weatherman, my forecast can be shot out the window.

So with that being the case, our sales team has been hesitant to do that because their fear is, if the price does go down, then the private label goes down, then all of a sudden we may have a higher disparity, and then they are not hitting their sales targets, if that makes sense.

Q. That does make sense. Thank you.

And so I'll ask you a question I asked Mr. Alexander. When Prairie Farms was looking back in '17 and '18 to support the change --

A. Yes.

Q. -- was it your understanding that the change was to help Class I processors hedge or to help the customers of Class I processors to hedge? Because I --

A. There's a distinction there.

Q. -- think I heard them both.

A. Yes. We looked at it as a view that we felt our customers would be doing more hedging, which would be also included in some of that private label business that we do.

As far as ourselves, again, we probably would not have done -- we weren't looking to do it for our branded product. It was more so to be able to have another tool in the toolbox to offer to our customers.

Q. And you talked about, in your statement, how your

customers don't seem to be utilizing that.
Have you had conversations with them as to why they are not, what goes into their thinking about why they are not using that tool?
A. A lot of them is the same fear as I just described with the sales -- about our sales team being out of price -- you know, out of whack. Is that if they locked in on a fixed price and the market went down, and their competitor didn't go down -- or didn't -- excuse me -- didn't hedge, and they went down, then all of a sudden it's a financial disadvantage, whether it be in lower margins or -- or just flat out too high of a price, and so you lose market share.
Q. Okay. On the last page 4 you have a table there. And I don't think anyone's asked you yet if you could just walk through for the record and explain the table, so we're not assuming anything incorrectly.
A. Sure. So for simplicity I'll just stick with July.
Farm A hedged 2.2 million pounds of milk at a hedge price -- or fixed -- they locked in Class III, because that's what they are paid off of, $18.93 for July of 2020. The negative -- and I'm going to keep them separate, and then I'll come back to Farm B. The negative PPD, which is in the -- I guess we'll call it the fifth column over, was a negative $7.51. So, hence, the farm on a Class III basis received $18.93 minus $7.51. Now, that wasn't what they totally received as a mailbox price

because they do get component values and so forth as part of their pay price, but that's -- that's -- in the simplest form, that's what that would be.

And then no different than for Farm B who hedged 150,000 pounds of their milk for the month, they hedged at a $16.53 price, and with a negative PPD of $7.51, they netted out $9.02. And, again, on a Class III basis.

Q. And so under these two examples you provided, it's Prairie Farms' position that the change -- the change is not only -- in your opinion, not being used by Class I processors to hedge -- or customers of Class I processors --

A. Correct.

Q. -- to hedge, but it also makes hedging for farmers more difficult?

A. We have heard from our producer base that it is -- and no different than Brian Henrichs who testified, that it's become more challenging for them to hedge.

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

MS. HANCOCK: Your Honor, we have no further questions. We would move to admit Exhibit 247.

THE COURT: Is there any objection to the admission into Exhibit 247?

There is none. Exhibit 247 is admitted into evidence.

(Exhibit Number 247 was received into evidence.)

MS. HANCOCK: Thank you.
Your Honor, at this time we would call Calvin Covington.
THE COURT: Would you state and spell your name, please.
THE WITNESS: Yes, ma'am. Calvin, C-A-L-V-I-N, Covington, C-O-V-I-N-G-T-O-N.
THE COURT: Now, adjust that microphone so that it's going to be comfortable for you. You're a tall man.
THE WITNESS: Is this okay?
THE COURT: That's perfect.
THE WITNESS: All right. Thank you.
THE COURT: Have you testified previously in this proceeding?
THE WITNESS: Yes, ma'am.
THE COURT: All right. You remain sworn.
THE WITNESS: Yes, ma'am.
THE COURT: You may proceed.
MS. HANCOCK: Thank you, your Honor.

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

DIRECT EXAMINATION

BY MS. HANCOCK:
Q. Mr. Covington, did you prepare Exhibit NMPF-34 in preparation for your testimony today?
A. Yes, ma'am. I did.
MS. HANCOCK: And, your Honor, I believe we're to

Exhibit 248. If we could mark that as the next exhibit number?

THE COURT: It will be so done.

(Exhibit Number 248 was marked for identification.)

BY MS. HANCOCK:

Q. Mr. Covington, would you proceed with your statement, please?

A. Thank you.

On the first page of my exhibit, I'm going to skip over part of that because it's the same verbiage of previous testimony.

But I will start out, this testimony is presented in support of Proposal 13, restore the original Federal Order Reform Class I skim milk mover as proposed by National Milk Producers Federation. And this testimony is presented on behalf of Southeast Milk, Incorporated, a longtime member of NMPF.

I'm going to skip over the next couple of paragraphs, but come down to clarify a question from my previous testimony.

As of June 30, 2023, SMI's membership consists of 114 dairy farmer members who own and operate 119 Grade A dairy farms. SMI estimates 93 of these members meet the Regulatory Flexibility Act's definition of a Small Business.

My testimony will focus on the challenges resulting from the use of the average-of versus the higher-of in calculating the Class I mover skim milk price for dairy farmers marketing milk under the Appalachian, Florida, and Southeast Federal Milk Marketing Orders.

Implemented in May 2019, the average-of has lowered revenue to dairy farmers compared to using the higher-of to calculate the Class I mover skim milk value. The revenue loss occurs when the difference between the Advanced Class III skim and Class IV skim milk price exceeds $1.48 per hundredweight.

From May 2019 through June 2023 the average-of decreased revenue to the three Southeastern Federal Milk Marketing Order producing pools by $192,371,500. And I had this there in Table 1. This revenue decline was a direct result of calculating the Class I mover skim milk price using the average-of versus the higher-of.

The use of the average-of has decreased revenue to Federal Milk Marketing Order pools, including the Appalachian, Florida, and Southeast Federal Milk Marketing Orders. This, in turn, has lowered the blend or uniform milk price.

As shown in Table 1, and using data from May 2019 to June 2023, the Appalachian Federal Milk Marketing Order's blend price was reduced by $0.38 per hundredweight; the Florida Federal Milk Marketing Order's blend price was reduced by $0.41 per hundredweight; and the Southeast Federal Milk Marketing Order's blend price was reduced by $0.36 per hundredweight. This is a significant and unexpected reduction in dairy farmer revenue from a milk price formula change that was intended to be revenue neutral.

Dairy farmers in these three Federal Milk Marketing Orders appreciate their fellow taxpayers providing partial reimbursement of the loss through the Pandemic Market Volatility Assistance Program. However, the revenue should have come directly from Federal Milk Marketing Order pricing provisions and the marketplace as the Federal Milk Marketing Order system is intended.

If the higher-of pricing remained in place, these inconsistencies would not have occurred. Taxpayers should not be required to cover the losses. The Pandemic Market Volatility Assistance Program was a one-time program. It will not be around in the coming years to save dairy farmers from the unintended lower pricing that occurs by using the average-of pricing mechanism.

The negative financial impact of the average-of was not limited to just a few months. During the 50-month period from May 2019 to June 2023, the average-of lowered the Class I mover skim milk price in 27 months, compared to what would have been paid had the higher-of price been utilized.

The average-of was lower than the higher-of two-months in 2019, eight months in 2020, six months in 2021, nine months in 2022, and two months in 2023, as of June. The average-of lowered revenue to dairy farmers before and after the coronavirus pandemic.

The negative financial impact of the average-of was not solely due to the Class III skim mover over $1.48 hundredweight higher than the Class IV skim mover. It was also due to the Class IV skim mover, $1.48 per hundredweight higher than the Class III skim mover.

MS. TAYLOR: Mr. Covington? Could you slow down just a bit?

THE WITNESS: Yes, ma'am.

MS. TAYLOR: Thank you.

THE WITNESS: Thank you.

From May 2019 to June 2023, the negative financial impact occurred in 16 months due to the Class III skim milk value exceeding Class IV by over $1.48 per hundredweight in 11 months when Class IV exceeded Class III by $1.48 per hundredweight.

More recently, both the June and July 2023 Class I movers are lower due to the use of the average-of calculation compared to the higher-of calculation. The July 2023 Class I mover skim milk price was announced at $7.88 per hundredweight. Using the higher-of, the July Class I mover skim milk value would be $8.94 per hundredweight, $1.06 per hundredweight higher than the actual price.

Worse yet, the average-of lowered revenue to dairy farmers at a time when dairy farmer margins are extremely low. The July gross margin calculated under USDA's Dairy Margin Coverage Program was only $3.52 per hundredweight. This is $6.40 per hundredweight lower than the margin in July of last year, and up to that time, it was the lowest margin in the history of the program. The average-of calculation is reducing dairy farmer milk prices during a financially challenging time for dairy farmers.

Further, the average-of calculation plus $0.74 per hundredweight limits any recovery of losses when there's wide variation between the Advanced Class III and IV skim prices. The average-of can only exceed the higher-of by $0.74 per hundredweight.

On the other hand, there's no cap on how much the average-of can fall below the higher-of. In December 2020, the average-of was $5.19 per hundredweight lower compared to the higher-of calculation. In October OF 2022, the Class I mover skim value was $2.08 per hundredweight lower than the higher-of calculation. The average-of inadvertently and unnecessarily places more risk on dairy farmers, and the downside risk is greater than the upside risk.

To date, the largest Federal Milk Marketing Order -- reduction in Federal Milk Marketing Order revenue --

THE COURT: Would you just start that paragraph again, please?

THE WITNESS: Yes, ma'am.

To date, the largest reduction in Federal Milk Marketing Order revenue resulting from the average-of was in calendar year 2020. The Appalachian Federal Milk Marketing Order blend price was reduced by $1.28 per hundredweight; the Florida Federal Milk Marketing Order blend price was lowered by $1.37 per hundredweight; and the Southeast Federal Milk Marketing Order blend price was $1.16 per hundredweight lower. At the time, dairy farmers were not assured they would receive any reimbursement for the losses sustained due to the blend price reduction. Such a large reduction in blend price was the tipping point for some dairy farmers to exit the dairy farming business. Such farm exits further reduced the milk supply in an already milk deficit marketing area.

Granted, a partial reimbursement was received for 2020 losses. However, it was not until 2021 and 2022 before partial loss payments were received, long after the time when dairy farmers had to pay their bills. This was a one-time remedy, and there's no guarantee of a future such remedy if this occurs again.

The Appalachian, Florida, and Southeast Federal Milk Marketing Orders do not have an adequate supply of farm milk year round to meet consumer fluid milk demand. Supplemental milk is purchased outside the three orders to meet demand. The average-of calculation resulting in lower blend prices makes attracting supplemental milk more challenging.

The three Southeastern Federal Milk Marketing Orders have the highest Class I utilization among all Federal Milk Marketing Orders. In 2022, the three Southeastern Federal Milk Marketing Orders combined for a Class I utilization of 73.7%, compared to 23.1% for the other eight Federal Milk Marketing Orders. The higher

Class I utilization results in higher blend prices in the three Southeastern Federal Milk Marketing Orders than for all other Federal Milk Marketing Orders. A higher blend price helps procure needed supplemental milk to meet fluid demand.

Due to the higher Class I utilization and the incorporation of the average-of, the three Southeastern Federal Milk Marketing Orders experienced a larger reduction in blend prices compared to the other Federal Milk Marketing Orders. This narrows the difference in blend prices between the Southeastern Federal Milk Marketing Orders and the other Federal Milk Marketing Orders, including those which have historically been a source of supplemental milk. It requires more money beyond Federal Milk Marketing Order blend prices to attract the supplemental milk needed to meet fluid demand. Dairy farmers, through their cooperatives, purchase most of the supplemental milk needed in the Appalachian, Florida, and Southeast Federal Milk Marketing Orders, which reduces dairy farmers milk checks.

Although my testimony focuses on the Southeastern Federal Milk Marketing Orders, the average-of creates challenges for all Class I handlers and all Federal Milk Marketing Orders. Milk handlers compete for the same milk for different uses.

As the Secretary of Agriculture pointed out in the 2000 Federal Order Reform decision, the Class I price should exceed Class III and IV prices. This is to ensure an adequate supply of milk for fluid use. This is a primary reason why higher-of was implemented back in 2000.

The Secretary of Agriculture understood what would happen by using an average-of the manufacturing milk prices versus the highest manufacturing milk price in establishing the Class I price. The 2000 reform Final Decision emphasized that using an average-of manufacturing milk prices to establish a Class I price makes it more difficult for Class I handlers to procure milk from plants with a higher value manufactured product.

The Secretary further pointed out the use of THE higher-of in the Class I formula makes it more difficult for milk needed for Class I to remain at manufacturing plants. Using an average-of two milk classes, III and IV, results in occasional difficulties for those supplying the fluid milk market to compete with those supplying the manufacturing milk market. The Class I price established by using the average-of approach may not be high enough to attract milk for fluid use.

Federal Milk Marketing Orders need to heed the 2000 Federal Order Reform decision and its rationale and return to the higher-of in calculating the Class I mover.

Federal Milk Marketing Orders have two primary purposes as contained in the Agricultural Marketing Agreement Act of 1937: One, maintain orderly marketing conditions; and two, protect the interest of the consumer by ensuring an adequate supply of milk for fluid consumption.

Using the average-of versus the higher-of makes it more difficult for Federal Milk Marketing Orders to meet those two purposes. Previous witnesses have testified how the average-of creates the opportunity for depooling, thus leading to disorderly marketing conditions.

Other hearing proposals related to the Class I mover skim milk price include an adjuster added to the advanced or announced Class III and/or IV skim milk prices. SMI appreciates the submitters of these other proposals recognizing the challenge with the current average-of method and wanting to make a correction.

However, these other proposals call for revenue losses to dairy farmers resulting from the average-of paid back to dairy farmers after the fact. Being paid after the fact creates challenges for dairy farmers.

Generally dairy farmers must pay their labor cost biweekly. Most other expenses are paid monthly or upon receipt of the product purchased. Dairy farmers need the revenue from milk sales now, not after the bills are past due.

Adjusting the Class I mover in later months to compensate for losses resulting from using an average-of creates challenges. Dairy farmers may not be compensated at all or not equitably compensated. Dairy farmers may have exited the business before receiving the adjustment. In some cases, the dollar difference between the average-of and higher-of may be the determining factor in their milking cows or not. The milk volume of some dairy farmers may be more or less when the adjustment shows up in their milk check, compared to the volume produced when the loss occurred.

Providing dairy farmers with the proper economic signal is vitally important. Making the adjustment after the fact could occur at a time when milk supply greatly exceeds milk demand. The economic signal at the time the adjustment is paid may need to be to produce less milk. However, the adjuster added to the Class I mover may be providing a different economic signal. On the other hand, at the time when the spread between the Advanced Class III and IV skim values is large could be a time when milk was needed. The average-of can fail to provide the proper economic signal.

It is good to see other dairy organizations recognizing the challenges in the current average-of method and their desire to correct it. However, the other proposals cannot improve on the higher-of as the method to calculate the Class I mover skim milk price.

In summary, the average-of has lowered dairy farmer revenue compared to the higher-of. The economic loss has been greater in Federal Milk Marketing Orders with an adequate supply of farm milk needed for fluid milk consumption.

THE COURT: Would you re-read that last sentence, please?

THE WITNESS: Yes, ma'am.

The economic loss has been greater in Federal Milk

Marketing Orders without an adequate supply of farm milk needed for fluid milk consumption.
Southeast Milk, Incorporated, expresses its appreciation to the Secretary of Agriculture and the Dairy Division for holding this hearing. We strongly encourage the Secretary to recommend the adoption of Proposal 13 --
Now, you see I have Proposal 3. I failed to update it from the original proposal numbers, so it needs to be a 1 in front of that 3.
-- return to the higher-of in calculating the Class I mover. This is needed to promote orderly marketing of milk and help ensure consumers have an adequate supply of fluid milk for consumption.
That's the end of my testimony.
BY MS. HANCOCK:
Q. Thank you, Mr. Covington.
Were you involved at the time that average-of was -- was implemented?
A. I was involved in the dairy industry, but I was not involved in putting that together.
Q. Okay. Well, tell me how you were involved in the dairy industry at that time.
A. Well, I retired from full-time work at Southeast Milk, but -- but since then, when I retired in 2010, I remained connected with Southeast Milk, advised them on various issues. And also, I have done some consulting work for other dairy organizations, and done a fair amount of speaking at various dairy organizations.

Q. And what -- what is it that you understood was intended to occur at that time?

A. Okay. Well, when that took place, you know, again, it was a part of that 2018 Farm Bill, and, again, it went in in May of 2019. And the first questions I received about it was probably when I was speaking down at the Georgia Milk Producers annual meeting. I got several questions there about it.

And what my response was to those dairy farmers, and also to other dairy farmers, I was very glad to see, finally, the dairy processors lobby and dairy producers coming together to support a change in Federal Milk Marketing Orders. I hoped that might be something good that would carry on, both processors and producers working together. And then I -- I knew people who had the developed it, and I told them I think I have confidence in those people, that they designed the program where it was to be revenue neutral.

However, and I have said this many times, I'm always very leery when Congress gets involved in legislating or changing Federal Order provisions. To me, Federal Order provisions needed to be changed in hearings like this where they can be properly vetted. Everybody can put in their own $0.02, you might say.

And this one, in my opinion, was done pretty quickly. And -- and, again, I'm not trying to fault anybody, but, again, it was done through legislation, not through a process like this.

But I says, if you read the legislation, you know, it has a two-year clause in there. So that tells me, well, let it work for two years, and then it says in there, if it doesn't work in two years, then we can come to a hearing to change it.

Q. And in your observations, and as you testified today, what is it that you -- that you believe that it was trying to accomplish at the time average-of was implemented?

A. Well, again, you know, I had -- I wasn't involved in it, so I got a lot of information just by reading it. It was trying to encourage fluid -- or make it easier for fluid milk processors or buyers of packaged milk to be able to use the futures contract and to help them -- and the -- use the futures contract in hedging their Class I milk price, and hopefully, maybe help to sell more fluid milk. I mean, that was what I could read as I quizzed people what the purpose of it was.

Q. In your observations since that implementation, do you believe that it's been able to accomplish those goals?

A. Well, again, we have heard previous people testify, right before me were two cooperatives that have fluid milk plants, and, again, their response was they were using it very -- using hedging very little or none at all on milk.

It's been a year now since I had regular contact with the fluid milk customers of Southeast Milk, but at that time, you know, in conversations with them, they had no interest.

And then knowing I might be asked a question here at this hearing, I asked the people now who are at Southeast Milk who are having regular contact with Southeast Milk's fluid customers, and still again, there's been -- there's been no interest.

Q. And this has been after four years of time within which, if there was going to be some hedging activity that could be conducted, it could have occurred at any point in time?

A. Well, like I say, it's been four years.

Q. Okay. And of all of the proposals that National Milk is putting forth at this hearing, what do you believe that the dairy farmers are most passionate or concerned about?

A. Well, I have been working for dairy farmers for about 50 years now, and when you work with dairy farmers that long, and attend a lot of dairy farmer meetings, get to know a lot of dairy farms, you hear dairy farmers voicing or vetting to you.

And there's been a lot of vetting done to me over -- over the years about so many different dairy policies issues, or this, that, and the other. But I'd say this issue of higher-of, whether I have been talking with dairy farmers in Florida, talking with dairy farmers in Oklahoma, Missouri, Kansas, Wisconsin, wherever, this higher-of has just really been at the top of the list. This has sort of got them more riled up than any other ones I can think of for a long time.

Q. And in 2021, we heard some testimony when Dr. Vitaliano was on the stand, in February of 2021, National Milk had -- had made some suggestions about using average-of with some kind of truing up at a later date that would put farmers in a similar position than if they had just gone back to higher-of.

Do you -- what do you think about whether that is a viable proposal as an alternative to the higher-of being implemented as National Milk has sponsored it?

A. Well, I give them credit for trying to correct it, and I even give people who put the other proposals with some kind of adjuster of trying to correct it. But I can tell you just based upon the feedback I received from dairy farmers, they are -- they want the higher-of back. That's the one they are comfortable with.

By nature, dairy farmers are very cooperative. By nature, dairy farmers are willing to give most anything a chance. And so they gave this a chance, but it's got them in the pocketbook. It's hurt them in the pocketbook, and so they are very suspicious of anything other than going back to the higher-of.

Q. Okay.

MS. HANCOCK: Your Honor, at this time we would make Mr. Covington available for cross-examination.

CROSS-EXAMINATION

BY DR. BOZIC:

Q. Marin Bozic Edge Dairy Farm Cooperative.

Calvin, how are you?
A. Fine. Thank you.
Q. Just a few questions.
Is it correct to state that there are no over-order premiums in Southeast today?
A. No.
Q. What would be the typical level of over-order premiums paid by retailers for Class I milk?
A. Retailers do not pay an over-order premium on raw milk.
Q. I apologize, for Class I milk that retailers buy from bottlers, do they pay --
A. They are -- there are over-order premiums in the Southeast.
And I guess I'm going to have to ask -- generally, I'm under confidentiality agreements with the cooperatives I represent on those -- as established in those over-order premiums, because it's part of marketing agreements that we have with the various fluid processors. I'd prefer not giving that since it's proprietary and confidential information, but there are over-order premiums.
Let me back up. Southeast -- I can't speak for other cooperatives. Southeast Milk does charge over-order premiums.
Q. And I certainly wouldn't want you to break any contracts. I didn't mean to ask you for that purpose.
But would it be fair to say that over-order premiums had a downward trend in recent years in

Southeast?
A. Yes, that's correct.
Q. And if there were -- and if they are on the way down, then that limits how much bottlers in the Southeast can afford to pay when they attract milk from other regions; is that fair to say?
A. I'm going back up just a minute, if you don't mind.
Q. Sure. Sure.
A. I'm going to go back to the downward trend.
Q. Yep.
A. Yes. There was a downward trend in over-order premiums in the Southeast, for particular Florida. But over the last year, 18 months, or maybe 24 months, there's been a trend coming back up of over-order premiums.
Now, they are still not the level that I think they need to be to adequately compensate cooperatives for the services they are provided, but the trend went down and is now starting to come back up. I hope it continues, but we don't know for sure.
Q. So how much can you share about what's driving the reversal in trend in over-order premiums?
A. Cooperatives started working together. When it comes to over-order premiums, cooperatives are their own worst enemies.
Q. Yeah. So have there been any unfilled orders by retailers calling their cooperatives asking for fluid milk products and cooperatives saying, we just can't deliver

because we cannot source milk? Has there been any such periods, prolonged periods, I guess, other than the first, maybe, six weeks of the lockdown where everything went haywire?

A. I could tell you -- and you have got both -- you're talking about processors and retailers and cooperatives. I can tell you there have been several -- because dairy farmers have taken pictures. There's been several instances over the last couple of years in the Southeast where some grocery store shelves have not had fluid milk on them, or very little.

I can tell you that the grocery store closest to my farm where I stop and get my milk, there's been more than one occasion when I have gone in there and the only thing has been just a gallon or two of skim milk.

And, again, I don't know whether that was the retailer or the processor. I do know there's been some -- you know, as you can -- processor cases where there's been some consolidation of processors in the Southeast.

I do know last year when school started, it was a challenge to make sure that schools could get milk, a lot of it just because of the distance involved. I know our cooperative had to get involved with one of the plants that we provide, find them additional milk so he could work with some distributors that supply the schools.

Again, nothing intentional is done, because, you know, we're in the business to sell milk, and farmers milking cows, and you know, we need to get it out there.

But I think there's been a variety of factors.

I can tell you that Southeast Milk, in the past, has sold fluid milk to other cooperatives in order to help them meet their demand. But over the past year, Southeast Milk has backed out of some of those agreements because it just didn't have the milk it needed to serve its own customers.

What's happening in the Southeast, and, again, you know, you were down there with me at Georgia, and you heard from those farmers. We keep losing dairy farmers, so the distance we have to come out to get milk just keeps getting further and, you know, greater miles.

Q. So the reason I'm asking about the unfilled orders or the over-order premiums, is because it seems to me -- please correct me if I'm reasoning inappropriately -- it seems to me that if the average-of introduced challenges in sourcing milk from other regions, then it would have manifested that such challenges would manifest either in form of unfilled orders or some form of charging customers above and beyond what normally they would be charged based on where the Class I price is.

Would that be a fair reasoning?

A. Well, I think you might have answered your own question right -- right -- right there, Doctor.

As I told you, in the Southeast, you know, premiums move down, but over the last couple years or so, have been coming back up. And it was -- again, it was -- and cooperatives have to work together to have successful over-order premiums. You got to work together, use a common marketing agency in order to make it work. If not, you are going to have unequal raw product cost among the processors.

So I think you sort of answered your question there, where milk prices got so low. Again, you see what --

Q. Sure.

A. -- the average-of, how much it lowered it. It finally got the attention of cooperatives, management, and cooperative leaders, hey, we better get back in the room and try to work this thing out if we are going to try to keep what dairy farmers we have.

Q. So if I've answered my own question, haven't they solved their own problem?

A. It's still a ways to go. Because when I first went to work for Southeast Milk, I know dairy farmers got me in the room and says, Calvin, you got to push the envelope when it comes to getting higher over-order premium.

And, again, I think all cooperative managers down there, cooperative leaders, are trying to push the envelope. And I was -- when I was back as CEO a year ago, I was involved in having discussions of trying to even up it more.

But the feedback I got from the customers of Southeast Milk is, okay, we'll do some, but we're still concerned. Our biggest concern is, we want to make sure that what I pay for milk is the same thing that guy over there is paying for milk. And there's still a lot of hesitancy, and that's what's held back bringing them up any further.

Q. Okay. I hear you. Thank you for answering that.

As you think about the 2017, 2018 deal between National Milk and IDFA, would it be fair, would you agree with the statement that the original sin, so to speak, of that deal is that it did not have a mechanism to get back fast to revenue neutrality?

A. Well, I wouldn't call it a sin. My definition of sin is probably a little bit different than that.

Q. Here you depool, you don't go to hell, so that --

A. Okay. I think -- and, again, you know, the two people involved in putting that together, one of them used to work for me for several years, and the other one's a good friend of mine. I think they went at it with their best intentions. Their best intentions. And I -- and it just didn't work. I mean, they're -- based upon the numbers in my testimony, it's cost dairy farmers money.

Now, I have to give -- you know, one of the hardest things to do if you put so much effort in a program and then it doesn't work, is to admit you were wrong. And so I have to give some credit to National Milk of coming up with this proposal.

Q. What do you think of the IDFA's proposal that would floor the mover to $0.74? So it can be higher, but not lower than $0.74.

Is it fair to state that over the long run -- and, you know, we can leave aside -- I would not dispute that some people will go out of business, etcetera -- but is it fair to say that the over the long run that would increase the price received over the higher-of?

A. I don't know. And, again, we are going to hear testimony about that probably later today or tomorrow or -- or the next -- or the next day. I mean, we just don't know what's going to happen.

But I -- I guess, I'm just going to go back. I am a firm believer in the higher-of. Even if we set aside the money issue, I go back to the purposes of Federal Milk Marketing Orders as I have outlined.

And if we go back in history, even back when -- back in the 1930s when we had licenses and the Federal Milk Marketing Orders were just starting, and cooperatives were working together in the New York City area trying to organize, if you go back and read that history up to now, when it comes to establishing the Class I price, we have got a history of taking the highest manufacturing price and going from there. And, again, even setting aside what it's done money-wise to dairy farmers, you know, I go back to that.

If we want to fulfill the purpose of Federal Milk Marketing Order to serve that Class I market, we need to start with the highest manufacturing price, just like I quoted the Secretary of Agriculture in the 2000 decision, and go from there.

Q. If you would indulge me and engage in a thought experiment. And I understand that you are not authorized to speak on behalf of an organization, if you are willing to share your opinion.
Let's say that IDFA were to come -- and I'm not saying this, I'm not obviously speaking on their behalf -- let's say they were to come and say, let's go with the higher-of, but with a floor -- and I'm going to offer a ridiculous number just to prove a point -- let's go with a floor of $3 per hundredweight.
How would you assess that proposal?
A. I can't speak for any other than Southeast Milk. But, personally, just because what I answered to you earlier, I would say no. You know, there's just something about pulling numbers out of air. I think a number, whatever number you use, needs to be based upon good, sound economics.
And, again, I go back of what we have used for -- for so many years in the Federal Order system, you know, start with the manufacturing price and go from there.
Q. Would you be willing to go on the record that you would also reject the proposal with a floor of $6 per hundredweight? I'm going somewhere with this.
A. Again, I just have an issue of, you know, picking a number, you know, without being -- you know, with sound -- sound economics on it.
Q. Okay.
A. And, again, I just -- I go back to -- to using the

higher-of. And I mean, we have done pretty good for, what, 65 -- well, excuse me, really didn't get going until 1962 when everything converted over from economic formulas to competitive prices, the manufacturing and the MW and so forth, of taking the highest manufacturing price and going from there.

Q. So where I'm going with the $3 and $6 is it seems to me that in addition to fulfilling the basic functions of Federal Orders, the point that you were referring to, it seems to me that the original design flaw of 2018 is not just the speed of convergence to revenue neutrality, it's also lack of compensation for the asymmetric risk.

Would you agree with that?

A. I had it in my testimony, you know, dairy farmers took all the downside risk.

Q. Right. Right.

So in other words, if there should be ever a consensus on higher-of, there -- an essential part of that would have to include a compensation for asymmetric risk?

A. Again, I'm not proposing that. You know, maybe there might be a proposal on that later on. But, again, I'm -- I go back, I'm a firm believer in the higher-of.

DR. BOZIC: No further questions. Thank you, Calvin.

THE WITNESS: Uh-huh.

CROSS-EXAMINATION

BY MS. VULIN:

Q. Good afternoon, Mr. Covington.

A. Good afternoon, ma'am.
Q. I'm going to ask about Exhibit 241. So I'm wondering -- I forgot to give a heads-up in advance that I would need a copy of that, so if you will give me just a moment.
THE COURT: And state your name for the record.
MS. VULIN: Ashley Vulin with the Milk Innovation Group.
May I approach?
THE COURT: You may.
BY MS. VULIN:
Q. This is Exhibit 241. It's a PowerPoint that Ms. Dorland put on on Friday. Were you able to listen in -- or Wednesday of last week. Were you able to listen in on her testimony?
A. I probably heard five or ten minutes of it.
Q. Okay. If you could go, please, to page 11 of this PowerPoint. She has some bar charts here that track proposal performance and dollars per hundredweight.
Do you see that?
A. Are you talking about these lines here?
Q. Yes.
A. I see them.
Q. And based on my review of those, it looks like, other than 2020, MIG's Proposal 15 would generate more money than NMPF's Proposal 13.
And so my question is, if that's the case, why is NMPF not supporting MIG's Proposal 15?

A. I'm not familiar with these calculations. Before I would want to answer that question, I'm always sometimes leery of other people's calculations, and so I -- I would like to study this before I would answer that question.

Q. So these came from NMPF's expert. And so I'll ask just for purposes of this question, if you could assume for me, assume that in 2019, 2021, 2022, and the first half of 2023, that MIG's Proposal 15 would have generated more revenue than NMPF's Proposal 13.

Would that change the proposal you think should be implemented?

A. Again, I'm here supporting higher-of, representing Southeast Milk, and we support the National Milk proposal.

I haven't done this kind of analysis. I would have to look at it and do my own -- and see if these -- if I felt these numbers were correct.

But, again, here I'm supporting the higher-of, going back to the higher-of.

Q. Have you done your own analysis of what kind of revenue the higher-of proposal would generate as opposed to MIG 's Proposal 15?

A. No, I have not.

Q. You said that the higher-of is one of the most emotional issues at this hearing for farmers, correct?

A. No.

Q. Oh, I thought I had heard you say that.

A. I did not use the word emotional.

Q. Oh, I'm sorry. I didn't mean to misstate your testimony.

Can you tell me -- or was it the most important? What are -- you had mentioned talking with farmers and having them feel very strongly about this. And I just want to get at, what about the higher-of, if it's not generating more revenue, what about that calculation is so important to dairy farmers?

A. As I said in answer to previous questions, dairy farmers are very -- by nature, very cooperative. They are -- they are willing to work with other -- anybody to try to help sell more milk.

And, again, when the average-of that the dairy processor lobby, the National Milk Producers came together and put together, again, they felt good about it here. And it's producers and processors willing to work together, and they took at face value that it was going to be good for everybody, that it was going to be revenue neutral.

And as time has showed -- and, again, you know, I had the numbers here in my testimony -- it's hit them in the pocketbook, and it's something they can see right upfront. Especially dairy farmers where I represent where it's a high Class I market, it's hit them more than other parts of the country. I mean, it's -- it's -- we are talking about 100 -- $92 million.

So they are very hesitant of deviating anything from the higher-of, and about somebody pulling numbers or pulling a number out, hey, we went with it one time, let's go back to something that we know and we're comfortable with. And plus, it helps meet the purpose of the Federal Milk Marketing Order.

Again, as I answered to -- to the doctor's questions, if we go back in history of regulated milk pricing, or back when cooperatives were trying to organize together in New York City working with milk dealers and so forth back then, it started with the highest manufacturing price and building from there to arrive at the Class I price.

And, again, the Federal Milk Marketing Order system adopted that after it went away from economic formulas with a -- with the Minnesota-Wisconsin in 1962. And it fits in with what the purposes -- one of the purposes of Federal Milk Marketing Orders, is to ensure that consumers have an adequate supply of fluid milk for drinking.

Q.   But the current higher-of, not the current, but the prior version that we're talking about here, wasn't adopted until Federal Order Reform, correct?

A.   Well, prior to the Federal Order Reform, we just had -- you know, we had Class III, and one time in there we had IIIA, I can't remember all the years. But the one we have right now with III and IV of, the higher-of, because we had two distinct classes, was adopted in January 1 of 2000.

Q.   But the version that was in place then was adopted when end product pricing formulas came into effect after

Federal Order Reform, correct?
A. The current version that we use right now, the higher-of, it -- and when we put in the extra class, Class III and IV, the way we determine the Class I mover now, as of Federal Order Reform, that started January 1 of 2000, was the higher-of the Advanced Class III or IV skim prices.
Q. And the purpose of the base Class I skim price formula is to further the goals of the FMMOs as enumerated by statute through -- by Congress and by USDA in regulation, correct?
A. No.
Q. What do you believe the purpose of the base Class I skim formula is?
A. To establish the Class I price.
Q. And do you --
A. It's a --
Q. And do you agree that the purpose of establishing the Class I price is to further the goals of FMMOs, which is to ensure a sufficient supply of fluid milk for Class I use?
A. The -- the Federal Milk Marketing Orders, as I had in my testimony, has two primary goals. It's to promote orderly marketing of milk and help ensure that the consumers have adequate supply of fresh fluid milk for drinking.
The classified pricing system that we have now, the Class I differentials, all the provisions of Federal

Milk Marketing Orders, we better hope so, that all of them work together to carry out those two purposes. Because if they all don't work together to carry out those two purposes, we're violating the Agricultural Marketing Agreement Act of 1937.

In fact, when I read the decisions that these people sitting over here have written in the past, they make sure that it complies with that Act. If it's not, it is illegal.

Q. And you mentioned earlier that the two-year clause that's in the statute that established the higher-of -- or excuse me -- that established the average-of currently in place.

Do you recall that?

A. I responded to that in the question, yes.

Q. So the two-year clause, then, required that the average-of be reconsidered in two years; is that right?

A. No.

Q. What did it require?

A. I don't have the exact language in front of me, so I'm going to have to paraphrase what it says. But it says to be in place for two years, and after two years you can go through the order system to change it.

Q. And so you agree that even within the statute authorizing the use of the average-of, there was an idea that it would be reconsidered as near as two years from then?

A. I don't know.

Q. Based on that language?
A. Based upon -- based on your question, I don't know. I don't know. I could give you my opinion of what I thought it was, but I don't know what the authors of that legislation.
Q. Well, that's a big question certainly, right?
But what is your opinion of what the two-year clause meant?
A. My opinion was, just like I have, you know, stated earlier, that was put in there that there might have been some reservation, some reservation, hey, let's give this thing two years and see if it works. If it doesn't work, we have a clause in here where we have a method where we can go and see about changing it.
Q. And you would agree that that likely built in some uncertainty as to whether or not the average-of would be remaining in place long-term, correct?
A. Could you repeat that again? I lost you there about halfway through.
Q. The two-year clause that you said indicated that perhaps everyone in two years should come and reconsider if this is the right approach built in uncertainty in the industry regarding whether or not the average-of was going to remain in place long-term?
A. What you said at the beginning is not how I answered your previous question.
Q. I'm not trying to misstate your answer. So will you clarify that for me and then answer the question I

placed?
A. As I understand -- and this is my opinion. I haven't interviewed people who wrote that. But when I read that, they put two years in there, said, hey, here's two years it has to stay in, but after two years, if we think it needs to change, here's the way we can go about changing it.
Q. And so you would agree with me, then, that that builds in some level of uncertainty as to whether or not it will remain in place after the two years? And by "it," I mean the average-of formula.
A. I wouldn't agree to use the word uncertainty. I'll go back to my previous answers here to you. That was put in there to let it go for two years. Then if it wasn't worked, there was a language in that legislation said, hey, we could go through the Federal Order process and make a change.
You used the word "uncertainty." I don't know if I would use the word uncertainty, but at least it gave a method in there if it didn't work, I guess that's probably the word I would use, hey, this is the way you can go back and change it.
Q. I have a couple of questions about SMI.
Does SMI operate any plants?
A. No.
Q. And how much of SMI's member milk is marketed to Class I fluid plants?
A. All of Southeast Milk, Incorporated's customers

are pool distributing plants. But because of balancing, there will be times of the year that milk would go to a non-pool plant.

Q. And you said Southeast Milk -- how does -- you said all of Southeast Milk's milk goes to a pool plant.

Do you mean all -- by that, do you mean Class I?

A. Now, that's not what I said.

Q. So then that was my question. So I'll ask again just to make sure we're on the same page.

How much of Southeast Milk's member milk is marketed to Class I fluid plants?

A. All of Southeast Milk, Incorporated's customers are pooled distributing plants.

Q. Okay.

A. Okay? Because of balancing, holidays, those type of things, there's going to be a percent of that milk that will end up going to non-pool plants.

We try -- I can't -- I don't have the numbers with me to give you an exact number, but it would be a small percent, because it costs a pile of money if we can't go to one of those pool distributing plants. But especially at holidays, springtime, especially around Memorial Day, we're going to have to find somewhere for that milk to go when we can't get it in the pool distributing plant. But our market is to go to the pool distributing plants.

Q. And you said that SMI's membership consists of 114 dairy farmer members who own and operate 119 Grade A dairy farms.

Do you recall that?
A. It's in my written testimony.
Q. Does SMI have any Grade B dairy farms that are members?
A. No, ma'am.
Q. Is it a requirement that a dairy farm be Grade A in order to be a member of Southeast Milk?
A. Yes, ma'am.
Q. How long has that been the case?
A. Day one.
Q. When was day one?
A. Southeast Milk was formed of a merger of cooperatives, and its starting date was October 1, 1999. And then all its predecessor cooperatives go back to the late '50s when commercial dairying started in Florida. And the best of my remem- -- and, again, it was started to market Grade A milk. In the best of my memory, and if I go back in history, I don't think any of those other cooperatives would have had a Grade B producer.
Q. Why?
A. There was no need to. The cooperative was formed to serve the fluid milk markets in Florida. The only cheese plants that you are going to -- well, there's one on the farm, but there's no to speak of commercial cheese plants in Florida.
Where you will find the most cheese plants, you will find -- you go down to Miami and you will find a bunch of people making cheese in their bathtubs, and that

type of thing, and so forth, and they get caught pretty regular. But just -- Florida is a fluid milk market.
Q. I have heard of rum in the bathtub, but not cheese.
You mention at the bottom of page 3 that certain dairy farmers have -- in the Southeast, have exited the dairy industry due to low prices.
Is that true in other orders as well, to the extent you know?
A. If you look at the total dairy farmer numbers that's published once a year by USDA, they list licensed dairy farms by numbers. You can find that. It comes out in January of every year by the National Agriculture Statistic Service. And that number's been constantly going down.
Q. Is it worse in the Southeast?
A. It's worse in the Southeast.
Q. But the base Class I skim price applies uniformly to all orders, correct?
A. The Class I mover or base price is the same in all Federal Milk Marketing Orders.
Q. And there's been a lot of talk about providing dairy farmers with the proper economic signals. What are the proper economic signals that the base Class I skim price should be sending to farmers?
A. The main reason that most dairy farmers go out of business, especially in the area of the country that I represent, it's just unprofitable. They can't make any

money. And you are going to hear from one that's going to be here tomorrow. It's just unprofitable in a few cases where the opportunity costs are greater than dairy farming. And so if we want to keep those dairy farmers in business, we got to make it profitable.

Milk price is one of the things that help makes it profitable. You know, again, there's other -- other -- and Southeast Milk has done some of it, too, to try to help them be better managers and so forth. But we got to make them more profitable if we want to keep them in business. Give them that economic incentive that, hey, we can make money, the kids can make money, the grandkids can come back and farm. And the milk price is one of the things that helps farm be profitable.

Q. And so the higher-of -- or you support putting the higher-of in place because that will ensure that FMMOs are creating prices that help dairy farmers remain profitable?

A. No.

Q. Okay. So then what are the economic signals that the base Class I price is sending to farmers? Because you had said that it needs to be profitable, so that's why I asked the follow-up of, so then that's the purpose of that market signal, but you said no. So I'm just trying to understand.

What are -- you talked about the base Class I skim price sending proper signals. What are the signals that you want farmers to get from that price?

A. Okay. We go back to the purposes of Federal Milk

Marketing Orders that we talked about, I have in my testimony. Again, we want orderly marketing, and also, to make sure we supply that Class I -- Class I market.

And one of the ways that Federal Milk Marketing Orders supply that Class I market is the Class I price is the highest of the classes. And the way -- up until the change of the average-of, if we go back in history, the Class I price has been established by starting at the highest manufacturing price and add the Class I differentials on from there, because you want to attract milk to serve the Class I market.

So in the market I represent, and I had in my testimony, that we're predominantly Class I. And if we want to increase the milk price, you know, we need to have an adequate Class I price that's going to help keep those dairy farmers in business so they can be profitable.

Q. And outside of the Southeast, if there's a sufficient supply of milk for fluid use, then you would agree with me the FMMO doesn't need to send a price signal to draw more milk for fluid use under Class I, correct?

A. No.

Q. Why not?

A. Because there are cases outside the Southeast where fluid milk plants or cooperatives supplying those fluid milk plants have challenges getting milk to serve them, to serve those plants, and they are having to go greater distances to do it.

Q. But they are able to get milk, correct?

A. Well, one thing you will -- and I don't know how much time you have ever spent with dairy farmers or dairy cooperatives, especially dairy farmers, they are going to do what it takes to get the job done. And, again, as a dairy cooperative, we have agreements with those fluid handlers to see that they got milk.

And I have gone all the way to New Mexico to find milk. Maybe a few times we had to go to Idaho, even in Florida. We'll do what it takes to supply milk to make sure they -- they have it, because we still got the local farmers there we need to keep that market for.

And so that's just the nature of the business. If you have a contract of supplying milk, you are going to do your best you can to find the milk.

Q. And on page 2 of your testimony you talk about how implementation of the average-of has lowered revenue to dairy farmers compared to using the higher-of to calculate the Class I skim mover value.

That's that table you have there, correct?

A. The table I have here just applies to three Federal Milk Marketing Orders: The Appalachian, the Florida, and the Southeast.

Q. Thank you for that clarification.

And the comparison here is the revenue that would have returned to farmers under the higher-of as opposed to the average-of, correct?

A. What I -- what I did in Table 1, I just took the monthly Market Administrator reports, did a pool calculation from each of those three orders, and just averaged up what the Class I skim value is. You can find it on those reports. And then I just went back and calculated it based upon using the higher-of, and calculated the difference, and then put the producer pounds, and just did the arithmetic.

Q. So this is the difference in the revenue generated by the higher-of and the average-of during that time period fort Southeast, correct?

A. No.

Q. I am really not trying to misstate things or catch you on anything. I just want to make sure that we're on the same page about what you are doing here.

A. It not only includes the Southeast Federal Milk Marketing Order, it also includes the Appalachian and the Florida Milk Marketing Order.

And, again, I'm talking about what's -- the revenue shows in the Federal Milk Marketing Order pool.

Q. Okay. What's the purpose of this table? Maybe that will get us this there.

A. The purpose of this table is to show the economic impact of what -- of higher -- of what the average-of has done to higher-of. And so the revenue that would come out of these three pools for this period of time was reduced by $192,371,500.

Q. So you are trying to show with this that farmers would have made more revenue under the higher-of than the average-of for these Orders?

A. I'm not trying to show you. These are the numbers. These are actual numbers that shows the difference in these three Federal Milk Marketing Order pools, what the difference would have been between -- in this Class I skim value, from using the higher-of versus the average-of.
Q. I think we're on the same page here, so I'm not going to belabor it any further.
But what I want to know is, have you run a similar -- is there any proposal at this hearing that proposes keeping the average-of plus $0.74 in place as is?
A. There's other proposals. And, again, I'm going to learn more about them as this testimony is presented, that is -- has -- again, I refer to it in my testimony, that uses an average-of versus an adjuster.
Q. Uh-huh. And so what I'm asking, is this comparison doesn't tell us anything about any of the current proposals, correct?
A. Because they are just proposals. I compared to what -- what's in place now.
Q. Okay. So this table doesn't tell us the difference between NMPF's Proposal 13 and the higher-of, and MIG's Proposal 15 with a different average-of, correct?
A. No, it doesn't.
Q. So it can't tell us anything between the proposals currently pending?
A. That wasn't my intention.

Q. And in -- in demonstrating the revenue that would have been generated between the higher-of and the current average-of, I had kind of a similar thought process to Dr. Bozic, that if we're just looking at revenue, isn't a proposal that's the average-of plus $10 the ideal proposal if all you consider is revenue?

A. Again, to me, that's theoretical, just picking a number $10. It would be nice if you would agree, you know, representing processors, that you wanted to add $10 hundredweight to the milk price, you'd probably get a lot of dairy farmers supporting it.

But I'm trying to deal with what's practical. I just don't think it's practical that everybody's going to agree to a $10 per hundredweight increase in milk price.

Q. Okay. So you agree that whatever proposal is adopted needs to both be practical and driven by economics?

A. In my history of working with Federal Milk Marketing Orders and going to these kind of hearings, the provisions has to take all that into account -- excuse me -- the decisions on the proposals has to take all that into account.

Q. And you'd agree that FMMOs don't create revenue, right? They distribute the created revenue amongst all of the producers?

A. Federal Milk Marketing Orders do not -- they can't -- Federal Milk Marketing Orders can't make money. They can't create money.

Q. They are there to distribute the money that the market generates, correct?
A. Federal Milk Marketing Orders have several different duties, and one of their duties is to set minimum prices based upon how milk is used to bring that money together in a pool and calculate a uniform price and to see that it's properly distributed to producers who meet the qualifications of the particular order.
Q. And you'd agree with me that that issue of depooling is created by the disparity between the announced Class III -- excuse me -- the Advanced Class III and Class IV prices relative to each other, correct?
A. Not necessarily. I'll refer you to -- and I think it was on the first hearing day number three, four, or five -- might have been -- one of the early hearing days, talking about Proposal 1. There was a -- a document, research paper referred to. I don't know if it was entered as an exhibit. And Dr. Bozic was one of the authors of it. And it broke down all the things that did impact or cause depooling. And I think it was four or five. I can't go from memory. I don't have a copy of it. But I would refer you to that. That would give you the breakdown. I think it had in there what the impact of -- of how much weight the average-of had in it or other things. But it was four or five factors in there, it wasn't just one single one.
Q. Great. Well, we'll take a look at Dr. Bozic's paper and revisit those. I appreciate that.

A. I mean, that'd give you more exact numbers than me just trying to guess.
Q. That's okay. Hearing day three was about 100 days ago, so...
So just the last thing I wanted to revisit. You had talked about over-order premiums. And so you would agree with me that for short-term, right, immediate milk needs, processors could pay over-order premiums to attract milk, correct?
A. You know, a processor can pay any price he wants to for -- as long as he pays the minimum price, if he wants to pay above that minimum price, that's up to him. I mean, there's no regulation to say he couldn't pay $100 a hundredweight for milk. That's up to him. But he's going to need to remain -- all the ones I have worked with got to remain com- -- want to remain competitive.
Q. And you said that the over-order premiums have gone down for about two years previously, but then this year they are going back up.
Did I remember that correctly?
A. No, ma'am.
Q. Can you tell me again what your testimony was about that trend of over-order premiums?
A. Yes, I can.
Over-order premiums -- and bear with me, I might be off a year or so on this -- but over-order premiums started trending down, probably hit their lowest about 20- -- excuse me, I can only talk to you about over-order

premiums in the Florida market.
Q. Of course.
A. Okay. That's all I have -- I mean, I got some of others, but the Florida market for sure.
They trended down, probably hit the low about 2019, 2020, and now they have started to gradually come back -- back up.
Q. What -- what, in your opinion, is driving them going back up?
A. Low milk prices, and finally the dairy farmers knocking their co-op leadership on top of the head with a two-by-four and saying, you need to get in a room and work together and try to get our milk price back up.
Q. Work -- you mean different cooperatives working together --
A. That's right.
Q. Sorry, just to make sure I finish my question.
You mean different cooperatives working together to ensure they're negotiating over-order premiums?
A. Yeah. The Capper-Volstead Act allows cooperatives to come together and form marketing agencies. And one of the main points when you are serving a fluid market, those fluid processors want to make sure they have got equal raw product cost. So the cooperatives got to work together in making sure they are doing that, and so they all got to agree on the same over-order premium.
Q. And because of that, cooperatives have been able to obtain higher over-order premiums in the last year or

so?
A. Progress is being made to turn them back up.
MS. VULIN: Nothing further for me, other than collecting Exhibit 241. Thank you.
MR. HILL: And while those record copies are being returned, I think this is a good time to suggest a break.
THE COURT: And would this be a ten-minute break?
MR. HILL: Yes, it would.
THE COURT: Good plan. All right. Let's go off the record at 2:32. Be back and ready to go at 2:42.
(Whereupon, a break was taken.)
THE COURT: Back on the record.
All right. We're back on record. It's 2:44.
And good, we have another examiner. You may identify yourself and proceed.
MR. MILTNER: Thank you, your Honor. This is Ryan Miltner representing Select Milk Producers.
CROSS-EXAMINATION
BY MR. MILTNER:
Q. Mr. Covington, I gave you back Exhibit 241, which you were asked some questions about before, and I actually want to look at the same slide you were looking at before on page 11.
So Ms. Vulin asked you some questions about the various proposals and their impacts. And I understood that -- that you have not intimately looked at this document, but I did want to ask you a couple of questions, if I might, about what, at least, this tends to show, if I

could do that.
And can you see by these graphs that they are trying to -- trying to reflect the proposals -- how do I want to state this correctly? I don't want to misstate it.
But that it's showing the various Class I movers for different periods of time. Do you see that?
A. I'm going to turn it sideways here.
Q. That's what I did here, too.
A. Okay. So I assume what you are telling me, each of those bars, is that the average Class I mover or average Class I skim value?
Q. I believe it's the skim value.
A. Okay.
Q. And so if you are looking at it in that orientation, the blue bar at the top is our current average-of III and IV plus $0.74. The next bar down is Proposal 13, followed by Proposal 14, and that's an adjusted average plus add-on, and then 15 is another adjustment to the average. And so here -- that's the lead-up to my questions.
In 2020, at least this analysis shows that Proposal 13, the higher-of, would return more than -- would have returned more than our current -- our current mover. And then in 2021, they are about the same, but the higher-of is slightly lower. In 2022, the higher-of is slightly higher. And then for 2023, for that period, they are about the same.

Now, here's my question. If -- if in some years producers end up with more under the average, and some years they end up with more under the higher-of, what is the main reason why your producers still want to have the higher-of as opposed to the average?

A. Well, first of all, as I responded to the previous attorney before you, this was the first I have looked at these numbers, and I haven't done my -- I haven't done similar calculations.

Q. Yeah.

A. But, again, as I responded before, we don't know what the -- well, I haven't responded to this. We don't know what the future is going to hold. I mean, we don't -- we don't know which of these proposals would generate more money going down the road. We can only make decisions based upon, you know, what we do know and what's happened in the past.

And as I testified earlier, you know, dairy farmers were willing, wanted to be cooperative in accepting the average-of. But they have seen what happened, what it's done to their revenue, and they are just leery of something new coming out. They are just -- they're just leery of it. Says, hey, we had this higher-of, we gave it up, and you can see what it cost us.

But, again, personally, I go back -- and you can call me a traditionalist or a purist or whatever -- but I go back to the Federal Milk Marketing Orders in establishing that Class I price. If we go back what's happened in history and tradition, it's worked to start with the highest manufacturing price as the base and go from there.

I'm willing, if we get -- well, I won't be around in -- if I'm around five or ten years from now and we find out one of these other proposals happened to be more or whatever, I don't know what dairy farmers will say. But I would be willing to stand up for them and tell them, hey, you know, we are doing something based upon what way it's worked by having the highest manufacturing price, then adding on to that, and that's what I advocate.

Q. Given your broad experience in the industry, would one of the reasons that the highest manufacturing price should be supported is because using that price helps to give producers the best economic signals about what milk demand looks like?

A. Yes. Over time, you know, it's just common sense. You know, milk is going to move to where it gets the greatest return. I mean, that -- I mean, it might not happen overnight because of contracts, logistics, other things, but over time, milk's going to move to its highest value.

Q. And just by nature of the average, I think you kind of blunt that message to producers, if you didn't rely on the highest of those prices, correct?

A. Yes. Maybe -- I mean, that's what we want to do. We want milk to move to its highest -- highest price.

Q. You were asked a few other questions about the two-year, the clause in the Farm Bill that -- that locked us into this average-of for two years. Of course we're out beyond that now. I think you were asked whether there was uncertainty as a result of that.

And it's true that any element of the Federal Orders are subject to being noticed for a hearing for consideration, correct?

A. It's my understanding any person can submit a petition to ask for a hearing to consider a change in a provision of the Federal Milk Marketing Orders.

Q. And that applies to Class I provisions, and Class II, and all of the classes, correct?

A. All the classes. Any -- any provision in the -- in any of the Federal Order regulations.

Q. And so for two years we were certain we were not going to deal with the higher-of or the average-of, correct?

A. As I read the law, what it said, for two years.

Q. Now, with respect to that provision, it's no more uncertain than any other provision in the Federal Order, is it? It's subject to a hearing just like any other.

A. Again, as I read the law, you know, it said that after two years you could go to a hearing with it.

Q. Okay. One other thing I had to ask you, and this is in your statement. It's on page 3. In the third paragraph you start off by stating, "Worse yet, the average-of lowered revenue to dairy farmers at a time when dairy farmer margins are extremely low. The July gross margin calculated under USDA's Dairy Margin Coverage Program was only $3.52."

So you have testified that part of the losses to producers were made up by taxpayers as part of the PMVAP program, correct?

A. Yes, sir.

Q. Now, as I heard you read the sentences, I just -- I just read back, it seems to me the taxpayers might have also picked up some of the cost of this change through DMC payments that might not otherwise have been triggered or were larger than they would otherwise be.

Would that be your assumption as well?

A. It's my understanding that part of the premiums under the Dairy Margin Coverage Program are subsidized. But, again, the part that's subsidized and where it's economical for how much coverage that you signed up for is geared more to the smaller dairy farmers.

The dairy farmers more in Southeast Milk, almost all of them are way over that. I can't remember the exact cap number. So if they participate in the gross margin program, they picked up a little -- a little bit.

But we got to remember, the dairy gross margin program is separate from Federal Order provisions. It's an entirely different program. You know, it's -- it's an -- I call it an insurance program. And to me, it needs to be kept separate from Federal Order provisions.

MR. MILTNER: All right. Thank you so much for that.

I'll grab that exhibit back from you so I can get that back to USDA.

MR. SJOSTROM: Your Honor, Lucas Sjostrom, Edge Dairy Farm Cooperative.

CROSS-EXAMINATION

BY MR. SJOSTROM:

Q. Mr. Covington, I'll be asking the same question I asked the previous two witnesses, in essence.

Is it better in a business scenario, as maybe CEO of SMI or any other entity, that you know -- is it better to know your revenue ahead of time for a future month, or if that number is the same, would it be better to know it the month after?

A. It's preferable to know in advance.

Q. That's all.

MR. SJOSTROM: Thank you, your Honor.

CROSS-EXAMINATION

BY MS. TAYLOR:

Q. Good afternoon.

A. Good afternoon.

Q. Don't have too many questions.

On page 3, if we could start in the middle of the page, and the paragraph starts "further." It's, "Further, the average-of calculation plus $0.74 per hundredweight limits any recovery of losses when there is a wide variation between the Advanced Class III and IV skim prices."

I'm wondering if you could talk about, that your

phrase "limits any recovery of losses," and if you could look at it from maybe the short-term versus the long-term perspective.
A. If -- I'm going to use the example -- and I hope I can do the arithmetic in my head okay, so you correct me if I get off.
So let's say that the -- I'm going to use regular round numbers -- say the Class III price is $15 and the Class IV price is $13.52, so that's $1.48 difference in there.
Using the average-of plus $0.74, or the higher-of, we're going to come out with the same Class I mover. All right?
If that $13.52 were to move up and both of them were to be $15, both III and IV, we could go up to $15.74. So the average-of is $0.74 higher. But that's -- on the upside, that's as high as you can go with the average-of.
But go back and we still have the $15, let's say that $13.52 went down to $10, then the average is $12.50. Add $0.74 to that, we're up to $13.24.
And so you see the downside risk is so much greater than what the upside risk is.
Am I -- was that your question or --
Q. Yeah, it was. I just was thinking, you know, I mean -- the discussion from National Milk witnesses has been about -- well, there's been many things, but one of the things is that the change was supposed to be revenue neutral. And I was wondering if you could touch on, given

the volatility in market prices that -- that's been discussed at the hearing, since 2017, right, things are more volatile, we have discussed that over many proposals.

Is it difficult under the current mover to ever return to revenue neutrality in the long-term if your upside is capped but your downside is never capped, as how you all perceive it to be?

A. In my opinion is yes. And the reason I say that, if we go back to 2018, when the work on that was done to be revenue neutral, it's my understanding that the representative from IDFA and the representative from National Milk Producers Federation worked together and they went back in history quite some time.

If we go back in history some time, it wasn't all that long ago we had the Dairy Price Support Program, and that kept prices a little more stable. If we go back in time, we weren't doing as many dairy exports. And when we see now exports can go up and down, that impacts the price.

So what -- this is just my opinion is, is when that calculation was done, they used the time period when prices were more stable, and so you -- based upon history, you would expect it to be more neutral by the -- by the average-of and $0.74.

But in my opinion, going forward, I think we're going to be -- going to see more volatility in prices. We're going to see greater spreads between the Class III and IV prices. And I think one of the reasons we're going to see that, I think is because of butterfat. I think we're going to see a new era with butterfat. Butterfat prices are going to stay higher. As butterfat prices go up, because of the way the formula is, it lowers the Class III skim value, but you have to bring up the Class IV.

So I think under the current system, looking forward, and nobody has a true crystal ball, it's going to be more and more difficult for the average-of plus $0.74 to be revenue neutral.

Q. Thank you.

On page 5 of your statement at the top, and you are talking about from the bottom of page 4, in Federal Order Reform, the decision and rationale to return to the higher-of calculation, and one is to -- the first one was to maintain orderly marketing conditions.

How would you define orderly marketing conditions?

A. Well, I will tell you, first of all, my definition of an orderly market, it might be a little longer than some people. All right? Because I think it's composed of several different things. And I think it -- and I'm going to start at the top of the supply chain.

What I consider to measure whether a market is orderly or not, I'm going to start with the consumer, that one indication of an orderly market is that you go into a grocery store or whatever, and that consumer can find fresh quality milk in that retail case. The case is going to have milk in it, it's not going to be empty. That's number one. And that gets back to the purpose of Federal Orders, consumers have milk.

Number two, that pool distributing plant or that fluid processor that's supplying that milk, that plant needs to make sure it's got an adequate supply of raw milk when they want it, when they need it, to make sure they can get the milk in that dairy case. And the price that they pay for that milk, they need to have assurance that's it's going to be an equitable or equal raw product cost with their other competing handlers within that same marketing area, and also have the proper balance in their price with any milk that might be coming from outside the marketing area of -- or from other marketing areas, to make sure everybody's operating under a level playing field.

The next thing on my -- on my list is, on the orderly marketing, that the dollars that that pool distributing plants are going to pay to dairy farmers or dairy farmer cooperatives, you know, needs to be paid in a prompt manner, know that the money's coming, and also, it needs to be paid uniformly so all the producers in that same marketing area have the potential to start with the same dollars coming from that milk. Again, we go back to the Agricultural Marketing Agreement Act talks about having uniform prices. That's one of the reasons we have pooling.

And then the last thing on my list is sort of a combination of some of those, that if we're going to keep order in the market, hopefully we got some stability of dairy farms in that marketing area that are supplying milk that were keeping them -- we're keeping that milk flow and not having a mass exodus of dairy farms.

So I put all those together is my definition of an orderly market. And the provisions that we're talking about here today, or the proposals put forth by the National Milk, hopefully it's helping to support all that.

Q. I think you talked about, or was it some other person on cross, I can't remember whom exactly, about how SMI customers you don't believe use any type of risk management tools, your Class I buyers.

Is that -- am I remembering that correctly?

A. Yeah. What my response is, it's been a -- a year since I have had regular contact with SMI customers of pool distributing plants that Southeast Milk sells to. At that time, none of them were using risk management on milk. They were -- might have been using it on orange juice or things like that, but not on milk.

In anticipation of this hearing, I thought I would receive a question about that. So the people now at Southeast Milk who have regular contact with the customers, I asked them, you know, to the best of your knowledge, your conversations with them, any requests, are any of them using it now? And, again, same response, no.

And then both to them, and also it was to me, their biggest concern, anytime you bring anything up like that, hey, we just want to make sure that what we're paying for milk is competitive, who we're competing with in the marketplace. For years that's been the number one thing I hear from the pool distributing plants.

Q.   So you understand their concern to be, well, if somebody -- if I use it but someone else doesn't use it, and they get an advantage later on, that's a problem?

A.   Yeah, because they are just -- it's such small margins in fluid milk, and it's -- what's the old saying, that two prices that consumers remember, the price of a loaf of bread and a gallon of milk, and they just want to make sure they are staying competitive with their competitor.

Q.   That's certainly what we hear about when we talk about inflation, isn't it?

A.   Yeah.

Q.   Okay. Another question. The witness from Prairie Farms talked a bit about their producer's ability to use risk management tools and basis risks because of negative PPDs.

Are you able to talk any bit about that when it comes to SMI producers?

A.   Well, one thing about it in the Florida market, most producers don't know what a producer price differential is, so we don't have to -- to worry about that.

Q.   That's true.

A.   In the past, when I was working there full-time, when the cooperative had its own feed mill, yeah, we'd forward contract on feed because we supplied a lot of our dairy farmer members with feed, and that's a common practice.

There's a few of them that are using -- will use the futures or are using the Dairy Revenue Protection plan. And I know of a couple that are using livestock gross margin. They were early on in that. There will be a dairy farmer from Southeast Milk here tomorrow that I think that might be using it some.

But based upon my knowledge, and I still maintain contact with most of them, it's a small number that are using any -- any risk management. When I bring it up, they come back to me, they say, Calvin, we'll use it if you will guarantee that we'll make money on it.

Q. If you could do that, you would have a lot of business.

A. Well, that's correct.

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

THE COURT: I must applaud you. Those were excellent questions, and the answers were stunning.

MS. HANCOCK: Then I have no further questions.

We would move to admit Exhibit 248.

THE COURT: Is there any objection to the admission into evidence of Exhibit 248?

There is none. Exhibit 248 is admitted into evidence.

(Exhibit Number 248 was received into

evidence.)

THE COURT: All right. This witness may step down.

Will you be remaining available?

THE WITNESS: I can be available -- is that correct?

MS. HANCOCK: It's your schedule.

THE WITNESS: Yeah. I'll be here most of this week. Then I'm back for another proposal.

THE COURT: Very fine.

MS. TAYLOR: Your Honor, I think next up we have Dr. Bill Schiek. I think he's next on the list to testify today.

THE COURT: Very good.

Dr. Schiek, you may -- so you are going to sit in the witness chair.

And is anyone going to ask you questions or are you going to be on your own?

DR. SCHIEK: Ask my own questions?

THE COURT: The exhibit is being distributed. Let's go off the record momentarily.

It is approximately 3:11 p.m.

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

THE COURT: All right. Let's go back on the record. Back on the record at approximately 3:12.

Dr. Schiek, would you state and spell your name?

THE WITNESS: Yes. Excuse me, my name is William Schiek. That's W-I-L-L-I-A-M; Schiek is S-C-H-I-E-K.

THE COURT: Have you previously testified in this proceeding?

THE WITNESS: I have.

THE COURT: You remain sworn.

THE WITNESS: Thank you.

WILLIAM SCHIEK,

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

THE COURT: I have been handed a document that's been marked as Exhibit 249. Is your copy so marked?

THE WITNESS: It is not.

THE COURT: All right. Would you read into the record how yours is identified up in the upper right-hand corner?

THE WITNESS: Mine is identified as Exhibit Dairy Institute-1.

THE COURT: Very fine.

Did you have an opportunity to mark yours?

THE WITNESS: I did not, and you know, I left my pen down at the desk.

(Exhibit Number 249 was marked for identification.)

THE WITNESS: Okay. Should I begin?

THE COURT: Let me -- let's go off record for adjust a moment.

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

THE COURT: Back on the record at approximately 3:14 p.m.

So, Dr. Schiek, you have marked your Exhibit 249.
And I have already forgotten, did you tell me you have previously testified in this proceeding?
THE WITNESS: I have, yes.
THE COURT: You remain sworn.
THE WITNESS: Correct.
THE COURT: All right. Good. You may proceed.
DR. SCHIEK: All right. Thank you.
My name is William Schiek, and I'm executive director of Dairy Institute of California. I have a paragraph in here of my background, but since we went through that the last time I testified, I'm going to skip down and just start talking a little bit about the Dairy Institute of California.
Dairy Institute is a trade association representing fluid milk processors and dairy product manufacturers with plants in California. Dairy Institute's offices are located at 1127 11th Street, Suite 718, Sacramento, California, 95814.
The Dairy Institute provides member companies with market and regulatory information services, and advises them on regulatory and legislative issues impacting their business operations. The Institute also serves as its members' primary advocate on dairy legislative and regulatory matters. Our membership includes companies who process fluid milk and cultured dairy products, frozen dairy products and ice cream mixes, cheese, and some packaged Class IV products, including butter and condensed

and evaporated milk. The positions on the proposals under consideration at this hearing were adopted by Dairy Institute's Board of Directors.

Dairy Institute's Regulated Pricing Principles.

Dairy Institute believes that regulated prices should be minimum prices that undergird the market. Disorderly marketing results from setting prices too high, whereas the market corrects if prices are set too low. Regulated prices should allow for the use of competitive premiums to direct milk to its highest and best use and, therefore, minimum prices should not intrude on the market so as to distort natural market signals.

Dairy policies should encourage, or at least not discourage, investment, innovation, and new product development, as these are the keys to unlocking more demand for dairy products. The minimum regulated prices for manufacturing classes, that is Class III and IV, should not be set above market-clearing levels.

In its 1999 Final Decision on Federal Order Reform, USDA stated, "The importance of using minimum prices that are market-clearing for milk used to make cheese and butter and nonfat dry milk cannot be overstated. The prices for milk used in these products must reflect supply and demand and must not exceed a level that would require handlers to pay more for milk than needed to clear the market and make a profit."

In setting regulated minimum prices, the danger is not in setting minimum prices that are too low, but in setting it too high. Regulated prices that are set too low, that is below the market-clearing level, can be compensated in the marketplace through competitive premiums. Regulated prices that are set too high can lead to the milk produced by dairy farms being dumped at the farm or moved out of area to find a processing home.

Minimum regulated prices must be set to levels where the plants can clear the market and operate profitably. Dairy Institute also believes that performance-based pooling standards are necessary to direct milk to Class I uses, and that Class I differentials should not be considered pure price enhancement for producers, but exist along with performance standards to encourage suppliers to serve Class I markets.

Dairy Institute's Positions on Submitted Proposals. Milk Composition.

Proposal 1: The National Milk Producers Federation, or NMPF, proposes to increase the assumed protein and other solids in Class III skim milk formula and the nonfat solids in the Class IV skim formula to national component averages. Specifically, National Milk Producers Federation proposes increasing the assumed nonfat solids test in Class IV to 9.3% and the protein test to 3.3% and other solids test to 6.0% in Class III skim. This change would increase the cost of Class I skim in all orders and the prices of Class II, III, and IV skim in the four fat/skim pricing orders.

Proposal 2: National All-Jersey proposes annually updating assumed milk components in the Class III and Class IV skim milk formulas using the previous year's weighted average-of component tests from milk component pricing orders with a 12-month implementation lag.

Dairy Institute opposes both Proposal 1 and Proposal 2.

Regarding manufacturing classes in fat/skim orders, it is true that milk with higher components will lead to higher finished product yields. A good argument can thus be made that producers should receive a revenue benefit from the higher component levels they produce, which result in higher yields in Class II, III, and IV products.

However, if underpayment is the issue, a better solution is for producers in those skim/butterfat pricing orders to petition USDA for a change to multiple component pricing. Such a change would ensure that handlers who derive a yield benefit from the higher components would compensate their suppliers for that benefit.

Components vary by order. Utilizing the average component test from the multiple component price orders could result in manufacturers overpaying relative to the components they actually receive, particularly if fat/skim orders average components are lower -- lower than those in multiple component pricing orders. Component data is available from USDA for the orders that currently have component pricing. The current fat/skim orders could have lower component tests than others, particularly in the summer months.

Regarding Class I, the changes in Proposals 1 and 2 would impose higher milk cost to fluid milk processors. Additional solids in Class I do not confer the same yield benefit as they do with manufactured products, so there does not appear to be a valid economic justification for applying the proposed change to Class I.

Furthermore, this proposal does not seem consistent with the idea of regulated prices as minimum prices, and there does not appear to be much evidence that fluid milk processors generally receive milk at milk component pricing order average component tests. The Dairy Institute believes that Proposals 1 and 2 should not be adopted.

Surveyed Commodity Products.

Proposal 3: National Milk proposes eliminating barrel cheddar from the cheese price calculation in the Class III formula. Dairy Institute opposes Proposal 3.

The relationship between block and barrel prices has become more variable since 2000 when the FMMO reform was implemented. Block and barrel markets are related, though not identical. Eliminating barrel prices from the Class III price calculation will put barrel cheddar manufacturers' margins under increased pressure when block prices exceed barrel prices, as Class III milk prices based solely on blocks would be higher than they are now. Eliminating barrels also lowers the cheese volume that is used in establishing milk prices.

NDPSR block survey prices are still largely driven by CME pricing. If we were to eliminate barrels from the NDPSR, there would be a somewhat greater likelihood of Class III prices being subject to thin market problems. Barrels are an important outlet for producers' milk, and their pricing conveys information about the overall supply and demand balance for cheddar. Such information would be lost from the FMMO prices if barrels were eliminated from the formula.

Proposal 4: The American Farm Bureau Federation proposes adding 640-pound cheddar blocks to the cheese price calculation in the Class III formula. Dairy Institute opposes Proposal 4.

While the inclusion of blocks would add more volume to the NDPSR survey price, it would add relatively little in the way of new pricing information to the extent that 640-pound blocks are priced based on the 40-pound block price.

Proposal 5: American Farm Bureau Federation proposes adding unsalted butter to the butter price calculation in the butterfat price formula. Dairy Institute opposes Proposal 5.

It is our understanding that most of the exported butter is unsalted and is also manufactured to international customers' requirements of 82% milk fat. Domestic butter is 80% milk fat and, therefore, a less expensive product. There is also a question of how subsidies on exported butter would be handled in the price reporting of the product.

Proposal 6: California Dairy Campaign proposes adding mozzarella to the cheese price calculation in the Class III formula. Dairy Institute opposes Proposal 6.

There are multiple types of mozzarella products sold and no clearly definable or agreed upon commodity type product. Mozzarella manufacturing requires additional steps and is, therefore, likely to have different costs than cheddar and different product yields. Including mozzarella prices in the cheese survey without accounting for these manufacturing differences would lead to an inaccurate representation of the milk value in the -- of the product.

Trying to account for all these differences between cheddar and mozzarella would unnecessarily complicate the formula. Dairy Institute believes that the minimum regulated price should be based on a definable commodity product with established standards. Cheddar cheese is the best product to be representative of the value of milk used in making cheese.

Class III and Class IV Formula Factors.

Proposal 7: National Milk Producers Federation proposes increasing manufacturing allowances to consensus levels of the following values: Cheddar cheese, $0.24 a pound; dry whey, $0.23 a pound; butter, $0.21 a pound; nonfat dry milk, $0.21 a pound. Dairy Institute opposes Proposal 7.

There is no transparency as to how the consensus Make Allowance levels in the proposal were determined. It is extremely difficult to evaluate how these consensus levels relate to actual plant costs of NMPF members or how representative they are of the current dairy -- of current dairy manufacturing generally.

National Milk Producers Federation witnesses have consistently acknowledged that manufacturing costs are higher than the levels in Proposal 7, significantly higher than the current Make Allowances established in 2008. But National Milk Producers Federation has provided little information regarding how far below current costs its proposed levels are. Also, the proposal lacks any timeline as to how and when Make Allowances will be updated to reflect current costs.

Proposals 8 and 9: Wisconsin Cheese Makers Association and IDFA have identical proposals to increase the Make Allowances for cheese, dry whey, butter, and nonfat dry milk, based on the simple average of 2022 costs derived from plant surveys, the Stephenson study, and 2022 costs estimated from regression analysis of CDFA manufacturing cost data, the Schiek study. Dairy Institute supports Proposals 8 and 9.

Under the Wisconsin Cheese Makers and IDFA proposals, 50% of the change from the current cost would be implemented in year one, with the remaining 50% being added in equal increments over the following three years, for a four-year total implementation, until the full 2022 costs are attained, or until dairy manufacturing costs from new USDA audited surveys are available.

Manufacturing costs were last updated in 2008 based on 2006 and 2007 data. An average of Stephenson's survey data with CDFA data was employed by USDA to establish the current Make Allowances in 2008. For the regulated prices generated by the end product pricing formulas to accurately reflect the value of milk to manufacturing plants, it is important that the manufacturing cost be as accurate and as current as possible. Given the time that has elapsed since Make Allowances were last updated, it is important that they be amended.

IDFA and Wisconsin Cheese Makers approach of using average cost data from two data approaches is reasonable given USDA's history of employing manufacturing cost data compiled by Dr. Stephenson and CDFA. The average cost data is more moderate than either study alone. Schiek's cheese cost estimates were higher than Stephenson's, while Stephenson's butter, nonfat dry milk, and whey cost estimates were higher than Schiek's.

Proposal 10: Select Milk Producers proposes increasing the cheese making fat recovery factor in the Class III formula to 93% from its current 90% value. Dairy Institute opposes Proposal 10.

Select's proposal would increase the butterfat yield in cheese from 1.572 to 1.624. In the past, a fat recovery value in the formula of 90% made sense, because even though some of the more efficient plants achieved higher fat recovery, older plants may not have been able to achieve the higher fat recovery of the most efficient newer plants. Therefore, from our view, a fat recovery of 90% in the formula was consistent with the notion of regulated prices as minimum prices.

Select has brought us expert testimony suggesting that fat recovery in newer cheese plants, or those using newer fat designs, may well be more than 90%, although specific level is not known. Our opposition to the proposal stems from the fact that we do not have data regarding fat recovery levels across many plants representative of the cheddar manufacturing industry.

Proposal 11. Select proposes to update the assumed farm-to-plant shrink factor in the Class III protein price formula to account for actual farm-to-plant shrink based on Select data. This would increase the yield factors for butterfat, protein, and butterfat in cheese. Dairy Institute opposes Proposal 11.

As was the case with Proposal 10, our opposition to Proposal 11 is based on the lack of broader data available on farm-to-plant shrinkage. The witness from California Dairies, Inc., (CDI) presented testimony suggesting that there are reasons to expect that farm-to-plant shrink in California might be higher than Select's proposal due to less than full tanker load shipments. Given the smaller farm sizes in the Northeast and the Midwest, farm-to-plant shrink there is likely even higher.

Proposal 12: Select proposes to increase the nonfat dry milk yield factor in the Class IV formula from .99 to 1.03. Dairy Institute opposes Proposal 12.

Nonfat dry milk yields based on solids going into the nonfat dry milk dryer are likely higher than the current formula yield of .99, owing to the presence of some amount of moisture in the finished product.

However, not all of the nonfat solids in producer milk end up in the nonfat dry milk dryers. Some nonfat solids from cream remain in the liquid byproduct of butter churning (buttermilk), and those nonfat solids end up in buttermilk powder. The lower yield (.99) is to compensate for generally lower buttermilk powder prices compared to nonfat dry milk prices and the higher costs associated with drying buttermilk compared to nonfat dry milk.

While noting that not -- that Dairy Market News information indicates that the buttermilk powder price discount relative to nonfat dry milk prices has narrowed in recent years, we acknowledge that the issue of the nonfat dry milk yield appears in need of additional study, but we are not supporting a change to yield at this time.

Base Class I Skim Milk Price.

Proposal 13: Nonfat -- excuse me -- National Milk Producers Federation proposes returning to the higher-of a Class I mover -- the higher-of Class I mover, instead of the current average-of plus $0.74 mover. Dairy Institute opposes Proposal 13.

Our opposition to this proposal stems from the fact that it would make Class I hedging extremely difficult, if not impossible, for most Class I processors. Our Class I members feel that the ability to hedge Class I milk is becoming increasingly important for some growing market segments, such as extended shelf-life products and foodservice.

In many of the these segments, our members are competing with other beverage options that have an ability to offer fixed pricing so that their customers, retailers and foodservice establishments, can plan pricing and promotion strategies more efficiently. Milk is at a competitive disadvantage to alternative beverages when our industry does not have the ability to effectively manage risk and offer fixed pricing to our customers. The current mover allows Class I processors to manage risks, while Proposal 13 would not.

Proposal 14: IDFA proposes an updated Class I mover that is the average-of the Advanced Class III and Class IV skim milk prices, plus the higher-of either $0.74 hundredweight or an adjuster equal to the 24-month rolling simple average difference between the advance Class III and Class IV skim milk prices.

Proposal 15, from the Milk Innovation Group, proposes to retain the current average-of formula for the Class I skim milk price and update the adjuster monthly using a 24-month lookback with a 12-month lag, that is for the preceding 13- through 36-month period.

The Dairy Institute supports both Proposal 14 and Proposal 15, as either proposal would align Class I milk prices more closely than the current mover with the prices generated under the old higher-of formula. Both proposals would also allow Class I handlers to hedge and provide a fixed price to customers who desire it.

Proposal 16: Edge Dairy Farm Cooperative, or Edge, proposes changing the Class I skim milk price to the announced Class III price, plus an adjuster. The adjuster would be a 36-month average, August through July, of the monthly differences between the higher-of Advanced Class III and IV skim milk -- III or IV skim milk price and the Class III skim milk price.

While this proposal would allow for Class I hedging using Class III futures contracts, Dairy Institute's Class I processor members are concerned that the lack of Advanced Class I pricing would be problematic. To be able to offer customers a pricing in advance of the month, the proposal might require hedging of all Class I milk, even standard HTST retail accounts where milk monthly Class -- where monthly Class I milk price changes are currently passed through to retail customers.

Alternatively, the proposal could require Class I processors to true up monthly with customers once the regulated price is announced after the milk has already been sold. It is unclear whether customers would accept this change and Dairy Institute members are not ready to support such change.

Proposal 17: Edge proposes a second alternative for changing the base Class I skim milk price to use the higher-of announced Class III or Class IV skim milk price. Dairy Institute opposes Proposal 17.

The lack of advanced pricing and a return to the higher-of methodology will not allow for Class I hedging, and the cost of milk would be unknown when it is sold to the retail customer.

Proposal 18: The American Farm Bureau Federation, that should be AFBF, proposes the elimination of advanced pricing on all Class I and Class II skim. It would change the Class I mover to the higher-of the announced Class III or Class IV price. The Dairy Institute opposes Proposal 18 as it suffers from the same shortcomings as Proposal 17.

Class I and Class II Differentials.

Proposal 19: National Milk Producers Federation proposes to increase the Class I differentials in all locations by various -- varying amounts with increases around the country by an average of roughly approximately $1.50 per hundredweight. Dairy Institute opposes Proposal 19.

Dairy Institute does not believe the Class I price differential increases as proposed by National Milk Producers Federation are warranted. In California, the proposal would increase Class I differentials by $0.70 to $1.10 per hundredweight depending on the county. It appears that the proposal would do little to incentivize the movement of milk to Class I plants, as Class I price gradients have not changed substantially. The proposal appears to be designed more for producer price enhancement than for facilitating orderly movement of milk to Class I markets.

To the extent that the cost of bulk milk transportation has increased, those additional costs are probably being paid in the form of higher transportation charges that cooperative milk suppliers charge their Class I customers.

Class I differential changes are historically contentious because they can have substantial competitive impacts with winners and losers. The additional Class I revenues available to Federal Order milk pools will further disadvantage producer cooperatives that own manufacturing plants and that are already contending with inadequate Make Allowances.

Conversely, cooperatives that own Class I plants or that are primarily milk suppliers to Class I processors will benefit from the higher Class I prices, as well as the elevated prices for other cheese -- for other classes that result from Make Allowances that are too low.

Proposal 20: MIG proposes to eliminate the Class I differential of $1.60 per hundredweight. It is arguing that the base differential is no longer needed to attract milk to Class I plants in milk surplus areas. Only location differentials would be added to the Class I mover to establish a particular county's Class I price.

The Dairy Institute is neutral on Proposal 20.

Proposal 21: American Farm Bureau Federation proposes increasing the Class II differential from its current value of $0.70 per hundredweight to a new value of $1.56 per hundredweight. Dairy Institute opposes Proposal 21.

The American Farm Bureau Federation proposal appears based on the notion that plants would be willing to pay as much as $1.56 above the Class IV price before they are incentivized to use ingredients rather than milk. Dairy Institute believes that Proposal 21 will result in nonfat dry milk being substituted for Class I skim in the production of Class II products. Therefore, the proposal should not be adopted.

THE COURT: Dr. Schiek? What's printed here in the next to the last line of that paragraph is Class II skim, and you -- you said Class I skim.

THE WITNESS: Ah. It should be Class II skim.

Dairy Institute believes that Proposal 1 will result in nonfat dry milk being substituted for Class II skim in the production of Class II products. Therefore, the proposal should not be adopted.

THE COURT: And that's as to Proposal 21?

THE WITNESS: 21, correct.

THE COURT: Yes. Thank you.

THE WITNESS: And finally, AMS Proposal.

Proposal 22: USDA proposes that it be allowed to make any changes as may be necessary to make the respective individual milk marketing orders conform with any amendments that result from the hearing.

Dairy Institute understands that the need to make conforming changes to the individual order language. However, we can neither support or oppose these changes until we know what they are.

That concludes my testimony on behalf of the Dairy Institute, and thank you for the opportunity to testify.

THE COURT: Let's take a five-minute stretch break. It's 3:43. Let's go off record.

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

THE COURT: Let's go back on record.

All right. We're back on record. It is approximately 3:48.

Mr. English.

MR. ENGLISH: Thank you, your Honor.

Chip English with the Milk Innovation Group.

I rise, your Honor, because, in addition to, I believe, Exhibit 249 --

MR. HILL: Yes.

THE COURT: So 249 is the one that --

MR. ENGLISH: The statement that he just read.

THE COURT: -- he just finished?

MR. ENGLISH: Yes. Dr. Schiek has also provided both USDA and yourself a document labeled, right now, Exhibit Dairy Institute-2, which is a one-page document, and I am wondering if we could have that marked as the next exhibit.

THE COURT: We will. I will mark it as 250.
(Exhibit Number 250 was marked for identification.)
MR. ENGLISH: And then I'd like to give Dr. Schiek an opportunity to explain what this document is.
THE COURT: Excellent. You may do so.
THE WITNESS: This -- thank you.
This document -- excuse me -- was requested by Ms. Erin Taylor, from USDA, in response to -- or during the cross-examination of me as -- in my earlier appearance, where I was presenting information on a cost modeling -- dairy manufacturing cost modeling analysis that I did.
And so she had asked for the websites for the different explanatory variables that were used in my analysis. And so what I have done here is listed each of those variables and provided the web address of where those -- where those -- where that data came from.
MR. ENGLISH: And that's all. I was trying to move the ball forward, your Honor.
THE COURT: Thank you. Appreciate it.
Now cross-examination of Dr. Schiek. Who would like to begin?
CROSS-EXAMINATION
BY DR. CRYAN:
Q. Good afternoon. I'm Roger Cryan with the American Farm Bureau Federation.
A. Dr. Cryan.

Q. Hello, Dr. Schiek. How are you?
A. I'm well. Thank you.
Q. It's always good to see you.
A. Good to see you.
Q. You oppose -- on behalf of the Dairy Institute of California, you oppose Proposal 4 because you believe that adding 640-pound blocks to the block cheddar cheese survey adds little price information because they are already priced --
A. Off of 40-pound blocks.
Q. -- off of 40-pound blocks.
So you agree they are essentially the same market?
A. Most of the time I think that's how 40 -- 640s are priced, based on my understanding and what I'm told. I also referred to the testimony from James DeJong earlier on 640s, because he sells a lot of them, and I don't.
Q. Okay. And so what would be the -- what would be the harm, what would be the damage of adding 640s to that survey?
A. I think -- I think the issue is, might be that when 640s are -- well, for one thing, they are often made to customers' specs, so there can be some differences in the product and in the specs that individual customers have. That, I believe, James DeJong testified to.
So the sort of commodity definition of them is not necessarily established because of those different customer specs.
I think the other issue is, when they are long,

they are sold at auction. There's no, like, clearing market for them, or clearing commodity market for them. At least that was what has been testified to, I believe. And so you don't have the same pricing information coming from that market-clearing function.
Q. So if it was narrowly defined according to commodity specification, that would help?
A. It would.
Q. Very good.
You oppose Proposition 5 on behalf of the Dairy Institute of California to add unsalted butter to the survey.
A. Uh-huh.
Q. Those -- the butter is graded according to the same standard, whether it's salted or unsalted; is that correct?
A. That's my understanding, yes.
Q. And there is substantial salted butter sold at 82%; is that correct?
A. I don't know the answer to that.
(Court Reporter clarification.)
BY DR. CRYAN:
Q. Okay. Would you agree that the best source of data for adjusting Make Allowances is an audited mandatory survey for processing costs and yields?
A. I think, yes, that would be the best source of data.
Q. And you used -- in your analysis, you used CDFA

surveys which were audited --
A. Correct.
Q. -- mandatory and audited surveys.
Would you agree that as one uses that data to extrapolate into the future, that it becomes problematic? That it's challenging? That for 2016, the data was very good, but the further out you extrapolate by whatever method, the more challenging it is to rely on that data?
A. I would say that in any econometric model where you are estimating from one dataset and then forecasting out, the farther you get out, the more challenging it is, yes.
THE COURT: Dr. Schiek, your voice is still very quiet compared to Dr. Cryan, so it will be nice if they are the same volume.
THE WITNESS: Okay. Is that better?
THE COURT: Yes.
THE WITNESS: Maybe I should take a drink of water.
DR. CRYAN: I think it's a little easier to hold this microphone in front of you when you standing here then when you are sitting up there.
BY DR. CRYAN:
Q. Would you agree that a CME Group Class I futures and options contract would address a lot of the risk management issues for Class I handlers that you refer to when you talk about the difference between the higher-of and the average-of?

A. I think a Class I futures and -- Class I futures and options contracts would be a marked improvement in terms of ability to manage risk, yes.

Q. And that would also address one of your major concerns in the elimination of advanced pricing?

A. It would -- it would -- it would address the concern of the higher -- of the idea of not knowing which product that you need to pick as your hedge.

Q. So what would -- what is the -- if there were a Class I -- if there were Class I futures and options, what is the damage, what is the harm to bottlers of eliminating advanced pricing?

A. As long as their customers are willing to accept -- well, as long as -- as long as there's enough liquidity, I would say, in the market for them to fully hedge advanced price versus the actual price they receive, then there probably isn't a problem. But currently we don't have that market. If one were established, there's liquidity issues for the amount of volume that would probably need to be hedged.

Q. Well, which leads to my next question, which is that there's an awful lot of the policy proposals from the Dairy Institute of California and IDFA, for whom you presented data, that seems to rely very heavily on the status quo and the current dairy futures and options complex. That would seem to make CME the arbiter of Federal Order policy.

Is that an appropriate situation to be in?

A. I think what I'm voicing here, first of all, we don't have any -- Dairy Institute does not have any proposals at this hearing. Dairy Institute is either supporting or opposing proposals that are out there.

But I think what I'm saying is, our position is based on our concerns. Our concerns are based on what's currently available to us in terms of managing risk. So -- you know, that's what I'm saying, basically.

Q. You do have policy -- I mean, whether you have submitted a policy, you have policy to oppose or support a variety of these?

A. Correct. Correct.

Q. Thank you.

And in the elimination of Class II advanced pricing for Class II skim milk, since the Class II butterfat is already priced on current prices, and because Class II is much more -- Class II processing and pricing seems quite a bit more like Class III and IV than it is like Class I.

Could you talk about what -- what is the harm, what's the damage of eliminating Class II skim advanced pricing?

A. Currently customers are -- are used to the Class II pricing that we have. And to the extent that there's passthrough pricing, that's -- that's what they are used to. And so eliminating that Advanced Class II skim pricing takes away that -- that ability to, at least, forecast that part of the of the price.

Q. It would disrupt what they are used to?
A. Correct.
Q. And regarding the Class II differential, the proposal from the Farm Bureau, American Farm Bureau Federation, how is the $1.56 proposal different from the original $0.70 logic, the logic behind the original $0.70 differential?
A. In terms of the logic, it's not. And I think -- but what we find is when powder is advantageous -- nonfat dry milk powder is advantageously priced, it's fairly easy to switch. And that full rewetting in the sort of drying and rewetting, isn't actually what needs to happen, because, you know, a lot of times you are able to rewet those solids with other dairy liquids that are already there. In other words, you are not, like, using 100% powder. It's -- you are using powder in addition to other dairy liquid products. So you are reducing the amount of Class II milk that you use and using more of the ingredient. And I don't think from a policy perspective it's necessarily good to encourage more powder use if you want to have Class II milk use.
Q. But do you -- do you realize that the Class II -- that the AFBF proposal for the $1.56 does not include a rewetting cost, it's just a drying cost?
A. I -- I guess I didn't realize that.
Q. Okay.
A. But I will say that when we look at the number that the members indicated, that they -- they could

utilize powder more efficiently -- or more often in that situation.

Q. And would eliminating Class II advanced pricing help avoid some of the price discrepancies, the price differences between Class II and IV that from time to time encourage that sort of reconstitution, as Class II prices lag behind falling Class IV prices?

A. I didn't do any analysis on that.

Q. And does -- does the use of ingredients help balance the market?

A. Yeah, I hadn't really thought of that as a balancing function. I think the products are being made, and usually there's powder available to buy, so --

Q. Okay.

A. -- it's a -- it's really a -- an arbitrage, a product form arbitrage decision.

Q. Okay. Of the sort that could help balance the market?

A. It could if it was -- if it was matched up. Obviously, it's another use of those products, so it's -- it would -- it would tend to lead more -- more producer milk from Class II use to Class IV use.

Q. Very good. Thank you for your testimony, and your being here, and your thoughtful responses.

A. Thank you.

DR. CRYAN: Thank you very much.

CROSS-EXAMINATION

BY MS. HANCOCK:

Q. Good afternoon, Dr. Schiek.
A. Good afternoon, Ms. Hancock. How are you?
Q. I'm doing fine. How are you?
I just have a few questions. You were talking about the purpose the Federal Order system.
Is it also true that in addition to the items you've discussed in your exhibit, that a purpose of the Federal Order system is a producer price improvement or an enhancement under the Federal Milk Marketing Order?
A. I think the purpose of ensuring adequate producer prices is to ensure that there's adequate milk, fluid milk, for consumers.
Q. Is it also true that a purpose is to enhance the producer prices as well?
A. Again, I think the enhancement of producer prices is to serve the larger goal of ensuring that the market is served.
Q. And in order to do that, you have to make sure that producers are fairly paid and they are able to stay in business?
A. Yes.
Q. And so is it also true that it was designed to neutralize or level the bargaining power between producers and handlers?
A. Yeah. I believe that was a purpose.
Q. And the net effect of that is that because of the Federal Order system, prices are higher for producers than they would be without a Federal Order system?

A. That's the goal, yes.

Q. On page 3 of your written statement in Exhibit 249, at the very bottom paragraph there, you have -- I think it's your third sentence, it states, "Regulated prices that are set too high can lead to milk produced by dairy farmers being dumped at the farm or moved out of the area to find a processing home."

Do you know what sentence I'm referring to?

A. Yes. Yes. I know what you are referring to.

Q. Do you have any examples of that occurring?

A. It was occurring in California at various times, okay, so this experience, this is when regulated prices were high and Make Allowances had not been adjusted in California, where we had too much milk in the state for the amount of processing capacity.

So the idea here is, you've got a market-clearing price. Supply and demand, graph crosses right here, right? If it's too high and it's above that, you have -- you have a supply that's greater than the demand at that price. So you have this issue of, okay, what do we do with the excess milk.

If it's below that, then you have got a situation where there's -- there's more demand at that price then there is supply, and that tends to bring the -- bring the price back to equilibrium, and it's done through competitive premiums, and that's a more orderly process than if you have a situation where it's too high and you don't have homes for the milk.

That's the argument I'm making here.
Q. Okay. And you said that you do have examples of when it had occurred in California?
A. We -- we saw that in California at various times from 2006, probably up until milk production peaked in California in 2014, I think.
Q. And during that time period between 2006 and 2014, when -- are you saying that that was the window of time in which the milk supply was too high as compared to the demand in the market?
A. Correct.
Q. And then what happened?
A. I think what happened -- well, we had the -- we had the financial crisis. That was the first thing that led to a drop in demand. And then over time, costs of production began rising, and then the price wasn't too high anymore. So milk production costs rose and milk production started declining.
Q. Okay. And it took the full eight years between 2006 and 2014 for the market to right itself under those conditions?
A. No. It would right -- you know, markets tend to move from one disequilibrium to another. So equilibrium is kind of a moving target concept.
What was happening during that time is you were having a lot of shocks to the market. So sometimes milk was in surplus, then -- then prices fell, and milk was no longer in surplus. And then sometimes production costs

would fall, and milk -- milk supply would grow again.
Q. And so when you say the market tends to, I guess, overcorrect itself, that's just the pendulum swung too far the other direction; is that right?
A. That often happens, yeah.
Q. So when you say -- I just want to talk about this timeframe in there. You said in around 2006 is when you believe that there was too much milk in California?
A. Uh-huh.
Q. Is that yes?
A. Correct.
Q. Okay. And -- and you believe that in 2006, the reason there was too much milk in California is because the prices were set too high?
A. The regulated price was too high. And I -- I say that because Make Allowances for manufactured milk were not -- not keeping up with costs. So there was a hearing in 2006, and that -- that spring there was milk being dumped in California. Some of that is on testimony -- you know, on the record in the CDFA testimony.
As a result of that hearing, the Make Allowance was increased. After that, we weren't having the problem with excess supply for a while. And then we had the financial crisis, demand dropped, and we had excess supply because of that. It was a different reason.
Q. So you are talking about manufactured products?
A. Yes.
Q. Okay. And this is at a time when CDFA was

conducting an annual survey of the prices in the market in California?
A. Yes.
Q. And -- and -- and then I think we talked about this previously, but then CDFA would bring the -- bring the data back that they would collect, and then apply all of the market conditions that they observed, and create a Make Allowance that they thought was appropriate for the market?
A. Correct.
Q. And they did this on an annual basis.
A. The -- the adjustment didn't necessarily happen on an annual basis. Pretty much like here, you know, you have to have a hearing, so someone petitions for a hearing. A petition is not always granted, you know. Generally they are looking for more support or, you know, real clear evidence in the data that that change needs to happen. So you might have petitions where there's no -- no hearing but -- so, again, long answer to a short question. It didn't happen on an annual basis even though the information was coming out on an annual basis.
Q. Okay. The information was available to CDFA in the market on an annual basis, but the change didn't necessarily occur to Make Allowances on an annual basis?
A. Correct.
Q. And you said it started in 2006, and then the financial crisis was, what, 2008 to 2010?
A. Yeah, that time period.

Q. Okay. And so the market factors, before a change could be made by CDFA under the regulatory regime, the market had some occurrences that tended to have an effect on the market as well?
A. Yes, there were other forces at work at times.
Q. And the -- was the -- that caused a decrease in demand in the market, and the supply and demand curve tended to right itself based on those market conditions.
A. Yeah. The -- well, the decrease in demand led to -- at least initially, led to an oversupply of milk. But then the high cost of -- or the low prices of milk, milk prices corrected, and that brought production down again. So you had -- you had both forces at work during -- at the same time, during the financial crisis.
Q. Okay. So in that case, it wasn't the regulated prices that corrected it, it was the market conditions?
A. In that case, yes.
Q. So back to your statement here where you said the regulated prices resulted in farmers dumping their milk or moving out of the area to find a different processing home, can you think of an example when that occurred that was related specifically to the regulated milk price that was set?
A. Well, I think that was the situation we faced in 2006 in California.
Q. Okay. All right. And then maybe just high-level, on Proposal 1, that's National Milk's proposal on the milk components.

A. Uh-huh.
Q. Were you here when National Milk put on its case related to the milk components?
A. I think I was here for -- for some of it, yes.
Q. Or listened to it?
A. Yeah.
Q. Okay. Is it fair to say that for the fat/skim orders, implementation of National Milk's proposal will cost processors more money in those areas?
A. I would say, yes, that would be true.
Q. And California Dairy, do you have any facilities out in that location, in the locations in those fat/skim orders?
A. We do not. And California's a multiple component pricing order.
Q. And would the changes proposed by National Milk cause an increase in any of the pricing that California Dairies would pay?
A. California milk processors you mean, in California, buying milk in California --
Q. Yeah.
A. -- is that -- not for Classes II, III, and IV.
Q. But it would for Class I?
A. Correct.
Q. Because based on whatever kind of mover that is finally settled on, it would still be based on the III and IV?
A. Yeah, I assume our component levels in California

are higher than the -- than the assumed component levels.
Q. So the financial impact of National Milk's proposal on California Dairy Institute would be that it would increase its Class I milk prices?
A. It would increase the Class I milk prices for members, yes.
Q. Okay. And then National Milk's Proposal Number 3 to eliminate barrels from the Class III pricing, does -- maybe I should back up.
I think when -- you kind of skipped over the introduction, but you said that Dairy Institute represents fluid milk processors and dairy product manufacturing plants in California; is that right?
A. Yes.
Q. How many plants do you have?
A. How many plants? I don't know. How many processors? We have 23 processor members who have plants in California. Some of them have more than one.
Q. And do you know what the makeup is as between fluid milk and dairy product manufactured products?
A. I would say right now we're probably about 50% of the membership, maybe a little more than 50% is doing fluid milk and/or cultured frozen products, and then the other -- the remainder is mostly cheese, with one or two fluid Class IV products.
Q. Okay. So about half of your membership has products in Class III?
A. It's probably a little less than half, yep. But

they are -- they are, by and large, larger companies that are buying more milk than the others.
Q. Okay. And then National Milk's Proposal 3 that would eliminate barrels from the protein pricing formula that would set Class III prices, if that were to occur, the net effect of that would be to potentially increase the price for Class III milk; is that right?
A. Yeah. Based on historic data, that would be -- that would be the case, because historically blocks are higher than barrels.
(Court Reporter clarification.)
THE WITNESS: Okay. Historically, cheddar block prices have averaged higher than barrels by -- by more than the $0.03 adjustment.
BY MS. HANCOCK:
Q. And Proposal Number 7, National Milk's proposal with respect to Make Allowance, you and I have already discussed.
A. We did.
Q. But if I can just summarize it here. One of your concerns with National Milk's proposal is that it doesn't go far enough in increasing Make Allowances; is that fair?
A. Yes. Relative to what we think costs are. Yes.
Q. Okay. And when you say "relative to what we think costs are," you have instead opted to support Proposals 8 and 9 for the Make Allowance increases that would ultimately result in a higher increase to Make Allowance?
A. That's true. That's what would happen.

Q. And so that would, in turn, reduce the pay price that your members would have to pay for the products that they -- for which they would get to deduct the Make Allowance.
A. That's true. Yes.
Q. And then, as I understand Dairy Institute's position, you oppose Select's proposal due to lack of information on shrinkage, fat recovery, and nonfat yields. Is that fair?
A. Yes. Are you talking about Proposals 11 -- 10, 11, and 12? Is there one particular one you are talking about, or all of them?
Q. I just kind of lumped them together.
A. Okay. Yeah. I think Select has done a good job of pointing to part of the formula. I just -- I think Dairy Institute members felt like we would like to see more -- a broader set of information before being comfortable making those changes.
Q. And the work that you did on your kind of metric modeling didn't include any yield data or analysis?
A. Did not. It did not.
Q. And you're not aware of anyone asking Dr. Stephenson to add yield data into any of his -- any of his analysis either?
A. I'm not aware, no.
Q. Okay. And then I want to turn now to National Milk's Proposal Number 13, which is the one we have been talking about this week, to move the -- from the

average-of back to the higher-of.
And you were present, at least today, for that testimony?
A. Today. Yes. Uh-huh.
Q. And it's fair to say that historically, since average-of has been put in place, it has resulted in a price point that was lower than what it would have been had the higher-of been paid; is that accurate?
A. That's been accurate to date.
Q. Okay. And one of the reasons that you have articulated for opposing National Milk's Proposal Number 13 to move to the higher-of is because of some concerns you have with whether hedging can be conducted using the higher-of; is that right?
A. Yes. That is the concerns that our members expressed.
Q. And do you know how much of your membership is -- is hedging today, using the average-of?
A. I don't know. I have heard from of my fluid milk processors. I have heard -- four of them have told me that they use futures for certain customers to hedge and provide a price for certain customers.
Q. Do you know what products they are using?
A. I don't. I believe it's mostly ESL fluid milk products, extended shelf-life fluid milk products.
I did have one who -- who said they had one HTST customer that was asking for it, and they were using it for that.

Q. Okay. And what about their customers, have you heard anything about their customers using any hedging tools?
A. I don't know what their customers are doing.
Q. Do you know what the risk exposure for Class I processors are that they are managing?
A. I do not.
Q. Does Dairy Institute do any kind of risk management or engage in any kind of risk management training?
A. No. I think we -- you know, we don't -- we -- I should say we have had and have invited -- during milk pricing workshops, we have invited folks to come in and do a session on risk management, but we don't do any risk management ourselves. We don't -- you know, we're not a broker or anything. We don't hedge for our members. We are just an advocacy organization.
Q. When you say "an advocacy organization," what do you advocate for?
A. We advocate on behalf of our members on legislative and regulatory matters.
Q. Things that have a financial impact on their businesses?
A. Yeah. I would say ultimately they are looking for the health of their business and the health of the industry --
Q. And --
A. -- so that they can do business in the industry.

Q. And do you know what risk management tools would be available to your members if the -- if we return to the higher-of mover for Class I pricing?
A. I don't personally know what tools would be available. I -- I know that hedging with -- with the contracts would be a lot more difficult. I don't know how you would construct that hedge.
I do know, I heard testimony that there are over-the-counter market makers who will -- will do something to provide a price, for a price.
Q. Okay. And all of the risk management tools come with a price, don't they?
A. Some -- some come with more cost than others. But, yeah, they all come with a price.
Q. Okay. And what about swaps, would that be an option if the higher-of movers were put back in place?
A. I'm not an expert on swaps, but I'm assuming that you might be able to find somebody to do a swap. I just do not know what they would charge for that swap.
Q. And what about options, would that be an option to have an option under a -- under a higher-of mover?
A. I think -- I mean, options are options on futures contracts, so I assume you would have the same -- some of the same issues.
Q. Forward contracting or fixed pricing, would that be an option?
A. Forward contracting can -- can be an option for some classes of milk. I don't see it as an option for

Class I.
Q. Okay. Do you know? I mean, have you done any kind of analysis?
A. I don't know anyone who is using it right now.
Q. Well, no one can use it right now under the higher-of model, right? Because it doesn't exist yet. Again --
A. Yeah, and there's an issue with -- with -- when you are below the regulated minimum.
Q. And then what about inventory? Is inventory used as a risk management tool?
A. For Class I?
Q. For Class I.
A. Not that I'm aware of.
Q. What about for ESL products?
A. I don't -- I don't know.
Q. Okay. If we look at page 10 of your testimony, your written statement, at the bottom, maybe two full sentences up from the bottom there's a sentence that starts, "to the extent." And it states, "To the extent that the cost of bulk milk transportation has increased, those additional costs are probably being paid in the form of higher transportation charges that cooperative milk suppliers charge their Class I customers."
Do you know if that is actually happening?
A. What I hear from my members in conversations is, is they will say they are paying more, they're paying higher transportation charges. And, you know, I think

that that's -- that's fair. Obviously if transportation costs have gone up, and cost of serving the market is higher, then they are paying those charges from their suppliers.
Q. Yeah. Do you know who is absorbing the cost of those transportation cost increases?
A. I would assume ultimately it comes through to the price charged to the -- to the retailer from the processor, if they can pass it on, if they can absorb that cost.
Q. And your statement here says that Dairy Institute opposes National Milk's Proposal Number 19 to increase the Class I differentials; is that accurate?
A. Yes.
Q. And if Proposal 19 were adopted, it would -- it would cost your membership additional monies to acquire its Class I products; is that accurate?
A. It would increase the Class I price, yes.
Q. And so that would be a yes, it would increase your members price as well?
A. Correct.
Q. Okay. If you turn the page, I'm at the top of the page 11 on your statement. And the sentence that started on the prior page but continues over, says, "The additional Class I revenues available to Federal Order milk pools will further disadvantage producer cooperatives that own manufacturing plants and that are already contending with inadequate Make Allowances."

I'm wondering if you can help me understand what you mean there.

A. So what I'm talking about there is to the extent -- if a manufacturing plant that's pooling its milk on the Federal Order and obligated at order minimum prices, it's paying manufacturing costs -- manufacturing prices -- so let's use a Class III, for example. They are paying a Class III price that doesn't -- doesn't have a Make Allowance that -- that accurately reflects the cost of converting milk into that cheese. That either creates a loss in the plant or the plant will pass that on to its member-owners. Okay?

A loss in the plant can be carried for a while by avoiding certain maintenance or, you know, new plant investments, putting them off for a period of time, but ultimately the producer who owns the plant is going to be paying that price.

So -- so that's the inadequate Make Allowance thing that -- where they are earning a price -- or having -- not having their costs fully -- fully covered in that conversion by the inadequate Make Allowance, if they are paying the regulated minimum price. Okay?

So then you have got a cooperative that's mainly selling milk, as opposed to turning it into a product and operating a manufacturing plant. So they are selling milk to customers.

If you increase the Class I price, they are going to benefit from that price in terms of the pool. They are already benefitting from the higher manufacturing milk price that doesn't fully reflect the manufacturing cost.

And so the manufacturing plant is kind of left with a -- with the issue of, do I pool to get the Class I revenues and pay that higher manufacturing cost, that manufacturing price that doesn't reflect my cost, or do I depool so I can not pay that higher manufacturing cost to the pool, but then I miss out on the Class I revenue. So it creates an unequal playing field for those two different handlers.

Q. Okay. And so you are saying in here, though, that it disadvantages the producer cooperatives.

Are you distinguishing that from the proprietary cooperative or from proprietary plants or --

A. Yeah. Here I'm just talking about two different types of cooperative handlers.

Q. Okay. And so you --

A. One that's selling milk and one that's manufacturing products.

Q. Okay. And so you're saying that the one that would be disadvantaged would be the one --

A. Manufacturing.

Q. -- that owned the manufacturing plant as opposed to the Class I?

A. Correct.

Q. Okay. I understand. Thank you.

MS. HANCOCK: That's all the questions I have. Thank you.

MR. MILTNER: Ryan Miltner representing Select Milk Producers.

CROSS-EXAMINATION

BY MR. MILTNER:

Q. Good afternoon, Dr. Schiek.

A. Good afternoon, Mr. Miltner.

Q. On Select's Proposal Number 10 regarding butterfat recovery, does the Dairy Institute, as an organization or any of its members, intend to introduce any evidence on the butterfat recoveries that they experience?

A. Not that I'm aware of.

Q. With Proposal 11, do any of the Dairy Institute's plants intend to introduce evidence on their experiences in measuring farm-to-plant shrink?

A. Not that I'm aware of.

Q. On Proposal Number 12 regarding nonfat yields and the uses of buttermilk, same question, does the Dairy Institute or any of its members intend to introduce any evidence or data on their experiences?

A. Again, not that I'm aware of.

Q. Okay. You had some questions earlier about high prices leading to milk being dumped at the farm or moved out the area, and you described California's experience in the 2006 to 2014 range.

During that time, of course, California operated its own order system, correct?

A. Correct.

Q. And I think during that period, whether explicitly

or implicitly, California adopted a policy of establishing prices at a level that incentivized the growth of manufacturing capacity in the state; is that correct?
A. That's correct.
Q. Would you also say that some of the movement of dairy farms out of the state were due to land values and the availability of what's known as a 1031 exchange?
A. I would say that 1031 exchange was used, particularly with dairymen who were selling out in Southern California.
Q. And in Southern California you had longstanding dairies that found themselves in the wonderful position, I suppose, of being able to sell their acreage by the square foot, correct?
A. Yes. And my understanding is, some of them relocated to the Central Valley and expanded there, some of them relocated to far-flung places like New Mexico and Idaho and expanded there.
Q. And those that chose to remain in California found themselves in the situation where they were required, if they were using a 1031 exchange, to invest their proceeds in agricultural operations, correct?
A. That's my understanding. I'm not an expert on taxes, but that's my understanding of how it worked, yeah.
Q. And usually those farms -- I guess I should ask this more as a question.
Is it your understanding that as those farms relocated, in many instances, they -- they vastly expanded

their herds?
A. That is my understanding, yeah.
MR. MILTNER: Thanks. That's all I have.
THE COURT: Tell me if you want another break before 5:00. It's now 4:35.
No? Just keep going until 5:00? Good. All right.
Are there any other questions before we hear from what the Agricultural Marketing Service will ask? No?
Let us hear from the Agricultural Marketing Service.

CROSS-EXAMINATION

BY MS. TAYLOR:
Q. Good afternoon.
A. Good afternoon, Ms. Taylor.
Q. I'm going to try not to be duplicative.
A. Good, because I only have a little bit of water.
Q. Oh, I can remedy that. Let's see.
On page 5, at the bottom, when you -- this is on regards to opposition to Proposal 5, adding unsalted butter. And the carryover sentence to the next page says, "There is also a question of how subsidies on exported butter would be handled in the price reporting of the product."
Can you expand on that?
A. I was thinking of the CWT program and any assistance given to selling exported butter.
Q. So that's not government subsidies?

A. No.
Q. That's private?
A. Private, right.
Q. Okay. I wanted to turn to Make Allowances, which starts on page 6. And first we have a carryover question from the first time you were here, so we'll not -- I will take this opportunity.
So the proposals that Dairy Institute supports and of which you testified on your own study, is averaging the Stephenson study with your own study.
A. Uh-huh.
Q. I guess one question is, why would it be appropriate -- why do you think it's appropriate to average the two studies when there are California plants accounted for in the Stephenson study, whereas in previous hearings, when we have updated Make Allowances, those studies were averaged, and at that time the CDFA study, because there were not California plants included in the Stephenson study?
A. Yeah. I think, again, because it's -- it's two different approaches to the same issue. I think if -- if you -- if you're fully comfortable with the Stephenson study, you know, it has California data in it. If -- if, you know, the fact that it's not fully audited is a concern, then this is another piece of data that I think has some -- some value for consideration.
Q. Okay. And at bottom of that first paragraph you have a sentence that "the averaged cost data" -- and

you're talking about the average of the two studies -- "is more moderate than either study alone."

Can you expand on how you find it to be more moderate?

A. Just an observation about, you know, where the average numbers come out compared to the individual numbers from either study. That's all it is.

Q. And can you talk a bit about your Dairy Institute members? I think what I caught was a little less than 50% of them have manufacturing plants in III or IV, and most of that is in cheese, of your members; is that correct?

A. Yes.

Q. So can you talk a little bit about whether or how their costs -- the manufacturing costs of those Dairy Institute members are or are not representative of the two cost methodologies we have in front of us?

A. Yeah. I don't know, you know, for example, who participated from -- other than I believe Hilmar indicated that they did, and they certainly, of the cheddar cheese making today, are a large part of that.

Beyond that, I'm not sure. We have a couple of other cheddar makers in California, and I don't know that they participated. I don't know if they did or if they didn't, but they would be smaller.

And, I'm sorry, now I have kind of lost your question in kind of looking at my -- my information.

Q. Sure.

So just a question, because I'm not sure if other Dairy Institute members will be testifying, trying to get an idea from your members' perspective, are their costs, you know, covered by the surveys as -- you know, before USDA right now to consider? Are their costs less than those survey results or more than those survey results? Like, trying to pull out some actual data, I guess, or thoughts on actual costs?

A. And I don't -- I would love to be able to help you. I don't know what those costs are on those other plants. I think, you know, given that, you know, Hilmar participated in the survey, I assume that it's probably -- you know, given how large they are, I assume it's probably fair to -- to say that they -- their costs are on the lower end. Right?

The other cheddar manufacturers are probably -- one's probably somewhat higher and one is probably much higher because one is sort of a plant that -- I would call them medium-sized and the other is a plant that's quite small.

Q. Okay. And do you know anything about your members when it comes to survey products currently, or products that we survey, so then we gather manufacturing costs on them, about your members' ability to invest in those plants to try to lower their manufacturing costs over the last five years?

A. Yes. I -- I don't -- yeah. I don't really know that information, internal information from those

companies, and probably couldn't say if I did.
Q. Okay. Turning to the next page, which is page 8, in your opposition to Proposal 12. Then you have, towards the end, middle, lower half of that paragraph, "The lower yield (.99) is to compensate for generally lower buttermilk powder prices compared to nonfat dry milk prices and the higher costs associated with drying buttermilk powder compared to nonfat dry milk."
As we look at -- it's a yield. So how did you come to this conclusion it's supposed to compensate for lower powder, buttermilk powder prices?
A. I think when I was reading the hearing decision from the 2000 hearing, there was a discussion of that in that decision, and that's -- that's what I read. I -- I think a witness from CDI talked a bit about that in his testimony as well.
Q. On the hedging proposal -- well, excuse me -- on the base Class I skim milk price, I think Ms. Hancock asked you about whether any of your members, fluid members, hedge, and I think you said you believe four of your fluid plants do that?
A. I talked to four who said they do that with some of their customers, yeah.
Q. How many total fluid members do you have, if I may ask?
A. Let's see if I can -- sorry, looks like about ten, if I added them up quickly. Actually, that's right, it's a little under 50% of our membership.

Q. Okay. Thank you.
I'm going to turn to page 10, and this is your discussion on the Class I and II differentials.
I want to start in the middle of that paragraph: "It appears that the proposal would do little to incentivize the movement of milk to Class I plants as Class I price gradients have not changed substantially."
I guess my first question is, what would you see as a substantial change, if what you are contending now is National Milk, whatever they proposed for California, you don't believe is substantial enough to actually make milk go to the fluid plants?
A. Yeah. I was thinking more about the location differences rather than the actual size of the differentials. So right now we have a $1.60 differential in sort of the Fresno, Tulare, Kings County, sort of that's the biggest milk supplier in the state.
And in Los Angeles, San Diego, that area, there's -- Orange County, where a lot of the population in the state is and where there's a lot of fluid milk sold, it's $2.10. So you have a $0.50 gradient, and I -- I don't think that gradient is changed in the proposal, which was surprising to me.
Now, maybe there's reasons for that, but, you know, I would -- I've heard it's more expensive to move milk into Southern California from the Valley, and a lot of milk does move that direction. I would have expected if the proposal was to incentivize movement, that there

would be more of a gradient there, but what we have seen is just all the differentials have gone up.

Q. Right.

A. That's what I was talking about.

Q. Okay. So is it appropriate for USDA to look at that or to look at where the actual supply area is for those locations? So the supply area for L.A., for example, where that milk comes from, to see if that gradient changed, which might be different than Tulare to L.A., for example?

A. Yeah, you probably would want to consider how the milk is moving, for sure.

Q. In your next sentence says, "To the extent that the cost of bulk milk transportation has increased."

I know Ms. Hancock asked you a few questions, and I'm not sure I caught all of the answers. But from your members' experience, or from your own knowledge of in California, do you see that the bulk cost of transporting milk has increased?

A. I hear from members periodically that their supplier has come to them and said, yeah, we have got to increase your transportation charge because costs are going up.

Q. And is it -- do you have an opinion on whether that transportation cost should be -- or whether it all should be or some of it should be captured in the Federal Order minimum prices, or done outside of the Federal Order prices?

A. Yeah. You know, I would argue that part of the purpose of the differentials is to help pay for a portion of that cost, of movement to help incentivize that movement. I think historically that's how the differentials have been viewed. I am not sure that if you increase the differentials, that those transportation charges would come down from the suppliers.

It would probably take an individual handler starting to build their own supply if they could do it for that, for the charges to come down.

Q. And on the sentence that ends that page and goes into the next page, and I know you had a discussion with Ms. Hancock about this, but I just want to make sure that we are clear.

So when you are talking about how the Class I change, differential change for National Milk, let's see, would be available in the pools but would further disadvantage producer cooperatives that own manufacturing plants.

So as I understand it, when I want to compare a manufacturing co-op versus a marketing co-op, that manufacturing co-op would have to decide, I'm either going to depool to recoup my manufacturing costs that I am not recouping in the order system, or I'll pool and capture the additional Class I revenue that I get to share.

So that's the decision you are making or that they have to make?

A. Right. Correct.

Q. I feel like I have a further question, but I haven't processed what that is yet, so -- let's see.
For Proposal 21 on the Class II differential, you state that you think "it will result in nonfat dry milk being substituted for Class II skim in the production of Class II products."
Do you have an analysis or any data to support that?
A. No. That was just what some of my members indicated based on when they looked at the numbers. As we were discussing a policy position on that proposal, that was what I heard from them.
Q. I think Mr. Wilson and I are going to contemplate your answer this evening.
A. I have a feeling you will probably be hearing some of these concepts again from other witnesses before we are done.
Q. We'll figure it out before we're done then.
MS. TAYLOR: That's it from AMS.
MR. ENGLISH: If there's no other examination, then I would, on behalf of Dr. Schiek, move the admission of Exhibits 249 and 250.
THE COURT: Is there any objection to the admission into evidence of Exhibit 249?
There is none. Exhibit 249 is admitted into evidence.
(Exhibit Number 249 was received into evidence.)

THE COURT: Is there any objection to the admission into evidence of Exhibit 250?

There is none. Exhibit 250 is admitted into evidence.

(Exhibit Number 250 was received into evidence.)

THE COURT: Dr. Schiek, before we let you go, do you have anything else you would like to add based on all those questions that have been put to you?

THE WITNESS: I do not, surprising.

THE COURT: All right. Thank you. You may step down.

How would you like to instruct us about tomorrow?

MS. TAYLOR: Thanks, your Honor. I think we have a number of people needing to testify tomorrow, and tomorrow's their only day, so hopefully we can make this all work.

I have Sara Dorland returning tomorrow to finish her cross-examination, and she was called on behalf of National Milk Producers Federation. Then we have John Umhoefer from the Wisconsin Cheese Makers Association that needs to go on tomorrow morning. And then I have two IDFA witnesses that will be here tomorrow, and I apologize, I don't have their first names.

MR. ENGLISH: Kimberly Greenbaum and Chris Herlache.

THE COURT: What's that second one?

MR. ENGLISH: Herlache, H-E-R-L-A-C-H-E.

We'll talk tonight about whether -- Ms. Greenbaum does not have flexibility. I don't know for a fact yet about Chris. But we're trying to work with people on this.

I heard some -- did someone say something about a dairy farmer?

MS. HANCOCK: That's Wednesday.

MR. ENGLISH: Oh, that's Wednesday. Okay.

MS. TAYLOR: So those are the only four that I have that need to testify tomorrow.

THE COURT: Is anyone else aware of a witness who wants to be on tomorrow?

DR. BOZIC: Dr. Bozic, your Honor, Marin Bozic. I can be tomorrow, if there's time. I'm flexible.

MS. TAYLOR: I have you on the list, Dr. Bozic. And I didn't know if you were here all week or you just had to be on -- I didn't know how your availability was.

DR. BOZIC: Well, if my marriage gets shaky, I might leave earlier, but otherwise I'm planning to be here all week.

THE COURT: But have you completed your proposal about the hedging?

DR. BOZIC: Our proposal is ever evolving to much chagrin of our -- of the parties.

MS. TAYLOR: So if we get through those four tomorrow, and I'm not sure if there's any farmers showing up to testify tomorrow in person, but then perhaps we can move to Dr. Bozic after that.

THE COURT: It will be a late night for you, lad.

All right. Good. Is there anything further before we go off record? No.

So we'll close this record at approximately 4:54, and we will go back on record at 8:00 tomorrow morning. Thank you.

(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: November 9, 2023

FRESNO, CALIFORNIA

Myra A. Pish

MYRA A. PISH, RPR CSR
Certificate No. 11613

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