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UNITED STATES DEPARTMENT OF AGRICULTURE 11: 48
Agricultural Marketing Service

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Milk in the Upper Midwest)
Marketing Area)
7 C.F.R. Part 1030)

Dkt AO 361-A39
DA 04-03
Victor W. Palmer, ALJ, presiding

Milk in the Central)
Marketing Area)
7 C.F.R. Part 1032)

Dkt AO 313-A48
DA 04-06
Marc R. Hillson, Chief ALJ, presiding

Milk in the Mideast)
Marketing Area)
7 C.F.R. Part 1033)

Dkt AO 166-A72
DA 05-01
Peter M. Davenport, ALJ, presiding

TO: U.S. Secretary of Agriculture, Administrator AMS, Deputy Administrator Dairy Programs AMS, and Presiding Administrative Law Judges

REQUEST FOR SUPPLEMENTATION OF THE PUBLIC RECORD OF PROCEEDINGS BY DISCLOSURE OF *EX PARTE* COMMUNICATIONS (5 U.S.C. §557(d) and 7 C.F.R. §900.16)

This Request is made on behalf of producers, handlers and other persons ("requestors")¹ interested in federal milk order hearing proceedings pending before USDA on amendments to federal milk orders for the Upper Midwest, Central and Mideast Marketing Orders, 7 C.F.R. Parts 1030, 1032, and 1033. The Request

¹ This request is made on behalf of parties interested in one or more of pending proceedings for rule amendments in the Upper Midwest, Central and Mideast milk marketing orders: Associated Milk Producers, Inc., Bongards' Creameries, Ellsworth Cooperative Creamery, Family Dairies USA, First District Association, Davisco Foods, Valley Queen Cheese Company, Wisconsin Cheese Makers Association, Family Dairies USA, Central Equity Milk Cooperative, Associated Milk Producers, Inc., Land O'Lakes, Inc., First District Association, Wells Dairy, Milnot Holding Company, National All-Jersey, White Eagle Cooperative Federation, Superior Dairy, Inc., United Dairy, Inc., Family Dairies USA, Dairy Support, Inc, Guggisberg Cheese, and Brewster Cheese.

seeks an initial remedy for *ex parte* communications to USDA officials, by DFA and its affiliates, by searching for and placing “on the public record” a copy of all written *ex parte* communications, and memoranda stating the substance of all oral *ex parte* communications, as required by 5 U.S.C. §557(d)(1)(C) and by 7 C.F.R. §900.16(c).

This Request is precipitated by facts that came to the attention of undersigned counsel on or about March 28, 2005. At that time, counsel received a copy of an audio CD containing a speech given on October 12, 2004, by Gary Hanman, President and CEO of Dairy Farmers of America (DFA) to the 97th Annual Meeting of Dairy Lea Cooperative in Syracuse, New York.² In attendance as a guest at the Dairy Lea Annual Meeting was Dana Coale, who had been appointed in early September 2004 as Deputy Administrator, Agricultural Marketing Services, Dairy Programs.

Pending before Dairy Programs at the time of the Dairy Lea Annual Meeting were formal rulemaking hearings for amendments to the Upper Midwest Milk Marketing Order (hearing held August 16-19 in Minneapolis, Minnesota) and the Central Milk Marketing Order (hearing notice issued September 17, 2004). These hearings were held to consider proposals advanced by DFA and others to make federal milk order pool participation for dairy farmers more restrictive and to address “negative PPDs” and depooling behavior resulting from negative PPDs.

Unfortunately, Mr. Hanman could apparently not resist the impulse to make a pitch to the captive audience, including the Deputy Administrator, concerning the merits of formal milk order hearing issues then pending before Dairy Programs,

² Since our receipt of the audio CD, the contents of Mr. Hanman’s October 2004 remarks have been transcribed by a professional court reporter. The transcription is attached.

Agricultural Marketing Service. Some of Mr. Hanman's remarks were made directly to Deputy Administrator Coale as the "new boss" of Dairy Programs.

Mr. Hanman speech to the Deputy Administrator and others gathered at the Dairylea Annual Meeting addressed, among other things, the following facts and issues relevant to pending hearings:

1. DFA's participation and role in milk marketing agencies in common and in milk marketing federations (Speech, Tr. 8-10);
2. DFA's visual aid display of "deficiencies in the program" (Speech, Tr. 11-12);
3. DFA's views on the desirability of for expedited rulemaking (Speech, Tr. 12);
4. DFA's views on the desirability of tighter, more restrictive, pooling provisions (Speech, Tr. 12); and
5. Negative PPDs and DFA's cash cheese trading activities on the Chicago Mercantile Exchange (Speech, Tr. 13-17).

Included with Mr. Hanman's presentation were visual aids, charts and graphs, to which reference was made in his speech, but of which undersigned counsel does not have copies. The transcript of the meeting made available to us also does not reveal any statements that may have been made by other attendees to the Deputy Administrator or to other Dairy Programs personnel in attendance, if any, in the course of presentations by speakers or in the course of social gatherings and meals.

Mr. Hanman's pitch to the Deputy Administrator at the Dairylea Annual Meeting clearly constitutes the kind of *ex parte* communication to which 5 U.S.C. §557(d) and 7 C.F.R. §900.16 are directed. The communications:

- (1) were made by "interested person outside the agency,"
- (2) were made to an agency employee "reasonably be expected to be involved in the decisional process of the proceeding,"
- (3) were "relevant to the merits of the proceeding,"
- (4) were "*ex parte*" within the meaning of 5 U.S.C. §551(14) and 7 C.F.R. §16 (e); and

- (5) were made after the prohibition against *ex parte* communications had been triggered, as provided in 5 U.S.C. §557(d)(1)(E) and set forth in the hearing notices.

While we deplore Mr. Hanman's efforts to lobby the Deputy Administrator on hearing issues then before the agency for decision-making, we also recognize that it would be contrary to the public interest for government administrators to isolate themselves from the public to avoid all possibility of *ex parte* communications, both innocent and egregious. The EPA General Counsel has observed:

It is probably impossible to prevent entirely the occurrence of improper *ex parte* communications. In a discussion of general matters between industry representatives and the Administrator, for instance, the conversation may inadvertently move to a matter which is involved in an adjudication. The Administrator must deal with a wide variety of topics, most of which are not covered by the *ex parte* rules, and should not feel constrained to avoid discussions with persons who are regulated by EPA merely because those persons also may be involved in some formal adjudication.³

It is neither uncommon nor improper for Market Administrator personnel and others in Dairy Programs to attend meetings of cooperative associations and conferences on dairy issues. Such attendance is consistent with their regulatory responsibilities to the dairy industry. However, it is also not unlikely, at such meetings and conferences, that the merits of hearing issues pending before USDA will be discussed as part of the program agenda or in social gatherings. For example, DFA's recent annual meeting in Kansas City included discussion of pending federal milk order hearing issues. Likewise, February's Southern Dairy Conference in Atlanta included Federal Milk Order hearing issues on the agenda

³ Clean Air Act enforcement policy documents, Dec 10, 1981, memorandum from Robert M. Perry, General Counsel, to John E. Daniel, Chief of Staff, Office of Administrator, EPA. <http://envinfo.com/caain/enforcement/caad49.html> ("EPA *ex parte* memorandum").

(see <http://www.ces.uga.edu/Agriculture/agecon/workshops/dcon2005.htm>), and was attended by a number of USDA Dairy Programs personnel and representatives for interested parties, including Dean Foods⁴, DFA, and others. These later events, if there were *ex parte* communications to or from interested parties, may also require supplementation of the record for the Mideast hearing, notice of which was issued on Feb. 11. The United States Court of Appeals for the District of Columbia Circuit recently acknowledged that while agency officials may need to meet with members of the regulated industry in order to properly perform their functions, an agency “wisely” places in the public record a copy or summary of *ex parte* communications even if there is just a “chance that the industry representatives were attempting subtly and indirectly to influence the outcome of [the] proceeding.” *Electric Power Supply Ass’n v. FERC*, 391 F.3d 1255, 12 ___ (DC Cir., Dec 10, 2004), citing *Louisiana Ass’n of Independent Producers and Royalty Owners v. FERC*, 958 F.2d 1101, 1112 (D.C. Cir. 1992). This process helps preserve the integrity of, and public confidence in, the agency decision-making process, as intended by Congress in the 1976 “Government in the Sunshine Act,” P.L. No. 94-409.

The APA and USDA Rules of Practice require that when an *ex parte* communication occurs, the communication be placed on the record for other interested parties to review. 5 U.S.C. §557(d)(1)(C); 7 C.F.R. §900.16(c). This neutralizes the *ex parte* nature of a contact, and allows other parties to respond as

⁴ The Southern Dairy Conference on February 15 included a morning presentation by the Deputy Administrator entitled “Where are Federal Orders Headed?” and an afternoon presentation by Ernest Yates, Dean Foods Company, entitled “Regional Competitiveness: A Processor Perspective.” Mr. Yates’s was one of the few presentations concerning which no material is reproduced on the SDC website. Inter-regional competitiveness in a federal milk order context, however, was discussed by other speakers (e.g., de Vries, “Federal order pooling strategies to protect local milk production”) and was one of the arguments advanced by DFA for its proposals in hearings for the Central and Mideast marketing orders.

they may deem necessary, including consideration of remedies provided in 5 U.S.C. §556(d). As further explained by the EPA General Counsel in the EPA *ex parte* memorandum:

The principal curative measure, once an improper *ex parte* communication has occurred and has been recognized as such, is to make the content and circumstances of the communication a part of the official record of the proceeding and afford the parties a chance to respond on the record. (If the communication was oral, a written memorandum of it must be prepared.) The written communication (or the memorandum summarizing the oral communication) must be forwarded to the Official of the Hearing Clerk, A-110, with a request that copies of it be furnished to all parties. This procedure is designed to nullify the "secret" nature of the communication and thereby preserve the fairness and integrity of the decision-making process.

This procedure has not, unfortunately, been followed by USDA after receipt of *ex parte* communications on pending milk hearing matters. This oversight must now be corrected. Although some delay in decision-making may ensue, responsibility for such delay lies squarely with DFA for not previously bringing to the attention of the record the need to neutralize the effect of its own *ex parte* overtures directed at USDA decision-makers.

Accordingly, we specifically request the Secretary, the Administrator, and Dairy Programs personnel who "may reasonably be expected to be involved in the decisional process of the proceeding"⁵ to review all records that may disclose *ex parte* contacts with interested parties from the time a Notice of Hearing was issued for the Upper Midwest Order hearing (June 16, 2004), including, but not limited to: (1) appointment calendars, (2) schedules of meetings and conferences attended,

⁵ 5 U.S.C. §557. Such personnel include, at a minimum, those identified in the hearing notices as subject to the *ex parte* rules: "Employees in the ... Office of the Secretary of Agriculture; Office of the Administrator, Agricultural Marketing Service; Office of the General Counsel; Dairy Programs, Agricultural Marketing Service (Washington Office) and the Office of the Market Administrator."

(3) correspondence, (4) phone messages and logs, and (5) travel schedules. If communications relating to the merits are located, or are recalled by personnel receiving oral communications, the documents or summary of oral communication must be placed in the public record of the proceeding(s) to which the communications are relevant. Upon placing such material in the public record, notice should be given to all known interested parties to allow an appropriate response, and consideration of additional remedial measures.

April 6, 2005

Respectfully submitted,

John H. Vetne

John H. Vetne
103 State St.
Newburyport, Ma 01950
978-465-8987
john.vetne@verizon.net

Attorney for Requestors

1 DFA Yesterday, Today and Tomorrow
2 Presentation by Gary Hanman
3 Dairylea Cooperative Annual Meeting
4 October 12, 2004

5
6 MR. GARY HANMAN: Thank you, Clyde. I
7 don't know what publication he's been reading but
8 there's some I'll send you that you didn't read, if you
9 are trying to look at, certainly, my pedigree. When
10 Greg and Rick asked me to come in and give a
11 presentation to you here today at your 97th annual
12 meeting, what they thought might be of interest to you
13 would be to give a little thought about DFA yesterday,
14 what we looked at at that time when we put it together,
15 where we are today, and then what we see down the road
16 as we look into tomorrow. And so the topic they
17 assigned me to cover this afternoon was DFA yesterday,
18 today and tomorrow. Yesterday and today are a lot
19 easier to cover obviously than tomorrow, but let me
20 start with that and see if we can get through this.
21 And hopefully as I go through this, if you have
22 questions you will write them down on either the DFA or
23 Dairylea scratch pads you picked up.

24 As you know we came together, DFA came
25 together on January 1 of 1998, and at that time there

1 were several things that were bugging the people that
2 put DFA together. I might add that the leadership that
3 put DFA together took almost a full year, the year of
4 1997, to design it because we had to totally redesign a
5 new dairy marketing cooperative. It was the first one
6 that anybody had ever put together on a national scale.
7 Up to that time we've had local cooperatives that had
8 been merged into regional cooperatives, but nobody had
9 put one together coast to coast on a national scale.
10 And there were several things that were bothering our
11 leaders at that time, and we want to cover some of
12 those. Concentration. The end of price supports and
13 maybe even Federal milk orders which meant that those
14 two basic government programs that had supported us
15 through the years were possibly going to be eliminated.
16 And then the whole issue of trade onshore and offshore
17 and the issue of trade barriers. And so they were
18 looking at how do we deal with these issues, issues
19 such as purer and purer numbers of dairy farmers when
20 you think in terms of concentration. The best data I
21 think for the number of dairy farmers come from the
22 Farm Bureau and they say now we have less than 70,000
23 commercial dairy farmers in the United States. Not
24 dairy farmers with milk cows, but dairy farmers,
25 farmers who have cows that they milk on a commercial

1 basis for an income stream. And so when you think in
2 terms of what we and Clyde and Rick are dealing with
3 and others, that all sugared-down group is very small
4 compared to what we used to think about when we look at
5 census data and we think there's a half a million or
6 more dairymen in the country. We don't have that many
7 commercial dairymen. So when we think about the
8 politics and government relations, how much are 75,000
9 dairy farmers and their families, how much are they
10 entitled to. Not only had concentration been occurring
11 at the farm, but the markets that we were facing
12 continued to shrink, and the biggest shrinkage was
13 occurring in the liquid milk side of our business.

14 The green bars that you see there, each one
15 of those are ten years apart. Those are the number of
16 plants that we had in 1975, '85, '95 and 2002. And so
17 we have seen a very rapid concentration of the market
18 that we were serving, not so much on the manufacture
19 side, cheese plants, the butter powder plants, those
20 that are making products that have extended shelf life.
21 But all of those are continuing to concentrate, and
22 that concentration was occurring because people to whom
23 they sold milk and dairy products were also getting
24 together, getting bigger, covering more geography. You
25 can see here the major retailers how they have changed

1 from '97, that's when DFA started doing the planning to
2 put our cooperatives together, and where they were last
3 year and you can see the percentage growth. I would
4 estimate that these six, five retailers sell about
5 close to 40 percent of the retail business. So our
6 formulators, our designers, our organizers were looking
7 at this concentration at the retail level in the market
8 where they sell their milk and then the demise of the
9 number of farmers geographically dispersed which led
10 them to a conclusion that we need a cooperative that
11 reaches shore to shore, border to border, so that we
12 can deal with this concentration.

13 They looked at the possible end to the price
14 support program and the end of the Federal milk
15 marketing order program because in 1996 when that
16 Freedom to Farm Act was passed Congress made a very
17 significant decision relative to how they were going to
18 maintain income to rural America. They were going to
19 do it in the form of direct payments, not in the form
20 of prices of things you as farmers sold. That was a
21 very major change in the way government was to address
22 rural America's economic well being. And that probably
23 more than anything was what put our group at least on
24 their toes to think that if we are going to direct
25 payments, do we need federal milk orders, do we need

1 price support, how about import and export assistance.
2 As Ed said this morning, we saw the price support over
3 time move from a percent of parity to a specific
4 hundredweight number and then down to 990 which really
5 was a truly low economic safety net but not a market
6 maker. And then with that, as Ed said this morning, we
7 have seen tremendous increases in price volatility
8 because when you have a perishable agricultural
9 commodity like milk and you have all changes in demand
10 or supply you get wild and wide price fluctuations.
11 And so with economic price support low and with that
12 variation above that level, we had wild price
13 fluctuations to deal with.

14 So how did we go about looking at some of
15 these trade barrier eliminations, what was at stake
16 with that. Well, the budget that was put together said
17 in six years we are going to do away with GAPP and we
18 were going to have NAFTA, and the whole trade trend in
19 international markets was one of opening up markets,
20 eliminating trade barriers. And these domestic markets
21 look like we are going to be a market of choice for
22 those around the world. Clyde mentioned to you in his
23 address this morning that we escaped the bullet in the
24 Australian free trade, put that in quotes, "free trade"
25 agreement, in that it is not a, quote, free trade

1 agreement, and that we do have restrictions,
2 limitations, quotas on dairy products that come in, but
3 over time those volumes, those volume limitations,
4 increase on a percentage basis working towards open and
5 free competition, long term. Long term. Our
6 organizers felt like our markets were going to be open.
7 Maybe not totally open, but much more open than they
8 have seen in the past.

9 In the past our domestic dairy policy had
10 been one of building a wall around the United States,
11 tailoring domestic supply to our domestic demand and
12 not aiming to do any export business, but at the same
13 time not allowing any outside intervention, outside
14 product to come in. And what would this change in
15 government attitude, the '96 farm bill. What our
16 organizers saw was that this wall was going to come
17 down one brick at a time over time, and that we had to
18 get ourselves in a position where we could do more
19 things ourselves and rely less and less on government
20 assistance and less and less on government protection.
21 Imports from lower cost countries were a threat. You
22 will hear from Jay Vogel this afternoon, not that he's
23 a threat, but the dairymen in his country produce milk
24 all on grass. And the products that are made from
25 their milk have a very low input cost because of that

1 relatively inexpensive feed source, and I would guess
2 their cost of milk to a manufacture plant would be half
3 of what our cost would be. So if we are going to have
4 free and open markets, and if we are the market of
5 choice, are we looking at and do we have to deal with
6 and be competitive with seven dollar milk. That's not
7 what we are talking about. That's not what we need to
8 plan for. We need to look at how do we stack up in the
9 world as far as cost of production, and then can we
10 compete in a different world environment. And I think
11 as our planners put DFA together that was the future
12 that they saw, and that we've got to learn how to not
13 only compete at home, but we've also got to learn how
14 to be an exporter and a participant in the world market
15 ourselves.

16 Where is DFA today. What are we doing today
17 in order to fulfill the mission, the vision the DFA
18 leaders had at that time. You already heard Clyde and
19 Rick talk about how we have all come together to be one
20 when we go to the marketplace. We recognize, I think
21 all of us recognize that it is going to be impossible
22 to get all dairy farmers in the United States into one
23 single marketing organization. If there is not an
24 alternative, history tells me, and I've been at it for
25 42 years, farmers will create an alternative at the

1 farm. Farmers will have a choice at the farm barn yard
2 gate. And that's not where it is important that we be
3 together. Where it is important that we be together is
4 when that milk arrives or starts toward a market or
5 when products made from your milk starts to compete in
6 the marketplace. And in order to have the maximum
7 effect on price, to do the best job in the marketplace,
8 the more of that milk that we can collectively market
9 together the better off we will be. And so you can see
10 how we have changed DFA's approach to representation
11 and marketing.

12 Our first recognition I think was with
13 Dairylea and St. Albans when we invited them, we asked
14 them would they consider becoming a member of DFA for
15 marketing purposes to where we could go hand in hand to
16 market together. Not to merge. Be separate in the
17 country, but be together when we went to town. Then we
18 had an option, an opportunity to take more market
19 responsibility for the dairy farmers who were selling
20 their milk, proprietary handlers, not through
21 cooperatives but as what we would call nonmembers. And
22 we organized a system whereby we could represent those
23 farmers in the marketplace where it counted for a price
24 and terms of sale were decided we needed to be one.
25 And so we created DMS, and we are very proud of that

1 and we need to give Rick and Greg and Clyde a lot of
2 credit and our Northeast council and Harold and Ralph
3 and Leon for putting this altogether and keeping it
4 altogether. That was no small matter. Within a period
5 of 90 days they reached out and assumed market supply
6 responsibility for in excess of 3,000 individual dairy
7 farms, picking up the milk, to dispatch the milk, to
8 move that milk to market, to bill it, to price it, and
9 to pay the member. And we did that. With a few
10 hitches, but we did that all within a very short period
11 of time, and you can thank Rick for doing that.

12 Then we also created what we call common
13 marketing agencies. Under the Capper-Volstead Act it
14 allows farmers not only to come together as
15 cooperatives into cooperatives, but also lets those
16 cooperatives create what the Act calls agencies in
17 common, which means that farmers get together and
18 market through cooperatives. They can ask those
19 cooperatives to do things together without being in
20 violation of any trust laws. The Capper-Volstead
21 exemptions lets us do that, create agencies in common.
22 We now call them common marketing agencies. What you
23 see on the map are common marketing agencies that we
24 are a part of that markets milk collectively with
25 multiple cooperatives being a part of that agency.

1 Some of these agencies are fairly primitive or basic in
2 that all we do, and that's significant, is we meet, we
3 have a board meeting, we all assess the supply and
4 demand for milk in that large bracket area, and we
5 decide collectively what we should charge for milk for
6 the next period of time, whether it is a month or a
7 quarter or whatever, and then we go home and charge it
8 ourselves. We do what we say we will do in that
9 agency.

10 There are other agencies that are much more
11 formal and tough and complete and what you might call
12 comprehensive, such as the one in the Southwest or the
13 one in the Southeast. In that case, those cooperatives
14 set down, they agree on a price, they agree on what
15 costs to supply that market they are going to share,
16 and in fact they've agreed they are to share them all.
17 Whether it is going outside the market and bringing in
18 supplemental milk and if that cost money, share that
19 cost. If it means getting rid of surplus within that
20 area, milk that is produced that we can't sell locally,
21 those costs are also shared in that agency. They have
22 also harmonized the producer program, what their
23 members, our members, their members receive in the
24 country relative to all types of producer programs so
25 that we are giving the right signals to members in the

1 country to produce the kind of milk, the volume of
2 milk, the quality of milk, the hauling situation so
3 that we are all the same.

4 And then they've taken another step just
5 recently. And you probably have read in the Dairy
6 Press we are building a very large cheese plant
7 outside -- five miles outside of Clovis, New Mexico, in
8 partnership with an Irish cooperative, and as a result
9 of that decision Glanbia and the dairy farmer had to
10 each raise \$30 million in equity capital to build this
11 plant, and that agency in the Southwest is raising
12 those dollars for that equity base from that super pool
13 program in the Southwest. So they really have taken a
14 larger step in pricing and pooling and sharing costs
15 and distributing dollars and now in equity generation.
16 But what we see on this map are all types of agencies.
17 They all work. Some are more comprehensive than others
18 and some of them might work better than others.

19 Federal order reform, we kept Federal orders
20 when the law was passed, if you remember, but we still
21 have some problems as we look today. Dana Coale is
22 here as Dwight has indicated. She is the new boss of
23 Federal milk marketing orders. We are glad to have
24 her. And what I've shown on the screen as deficiencies
25 in the program are not her fault, but they are

1 something she and us have to solve. It takes too long
2 for us to have a hearing, to get a hearing in the first
3 place, build a record, and then get the results of that
4 record into place. We need some way to help her make
5 that decision sooner. We think in our case that we
6 have too much participation in some of these fluid
7 pools from milk sources that do not intend to satisfy
8 that market demand. They are not in there to sell milk
9 for the fluid market, which is what the Federal orders
10 are designed to price, but they are in there really to
11 just siphon some milk out of the pool. And so in our
12 case and I think in DMS' case, our goal is to tighten
13 those pools and ask that if you participate in the pool
14 you've got to perform.

15 We have a major problem with what we call
16 producer handlers. You may call it producer
17 distributors. As these dairy farmers have gotten
18 larger, they have looked at selling their milk off of
19 the farm in gallon jugs or half gallon jugs instead of
20 in 5600-gallon tankers, and they have gone to some
21 major supermarkets and have cut some deals on gallons
22 and half gallons of milk. And as a result of that,
23 Federal milk orders do not price their sales. They are
24 exempt. When the Federal orders were passed in the
25 early or the late '30s, when we got the authority for

1 Federal orders, there were a lot of small farms that
2 were selling milk out the back door of their milk house
3 and they were excluded. Producer distributors,
4 producer handlers were excluded from regulations under
5 order, and since that time we have not been able to
6 cause regulations to apply. And so now we have a
7 lot -- they are like a Dean Foods who has to comply
8 with an order in a classified system of pricing. It
9 means that his milk that he puts in a bottle he gets
10 class one cost for that, and if his competitor is a
11 producer handler, a dairy farmer, who is looking at a
12 less of a return his cost might be less for his milk in
13 a jug, in a gallon jug, than Dean. So we have to be --
14 as an industry, we have to help Dana and the Federal
15 milk order program make regulations totally applicable,
16 whether producer distributors or whether they are
17 regulated handlers like Dean. If we don't, and if we
18 can't get that done, and that will take new
19 legislation, the classified system of pricing that
20 we've known will go away.

21 And then we have to deal with negative EPDs.
22 That is the most difficult Federal order feature that
23 you have ever asked us to explain. And I'm not sure
24 that I can do an adequate job in doing that. How in
25 the world can you sell your milk in a month in a market

1 and then wind up getting a bill for it. We have to sit
2 down with Dana and work on how we eliminate under the
3 orders negative EPDs without, without giving up the
4 value that we got out of the marketplace for things
5 that we made from that milk. We think it can be done.
6 Some of our problems.

7 DFA, I think I have told you before,
8 believes in being a market maker. We believe it is not
9 only running businesses for profits and running
10 businesses for market access, but if possible using
11 those businesses for price enhancement to you and your
12 milk check. Each year prior to our -- the start of our
13 fiscal year, which is January to December, we sit down
14 with all of our manufacturing plants and we total up
15 what we think we will make for the next year, just like
16 the people in New Zealand do. And we, by design, plan
17 to make, to manufacture less American style cheese than
18 we sell, so we will be a buyer of cheese. To be a
19 buyer of cheese we think that puts us in a position to
20 put upward pressure on price, assuming that our company
21 can stay with it, such as our Gordon cheese company.
22 And so this last year our plan was to be 400 loads of
23 cheese deficit and to buy some of that cheese on the
24 CME. Chicago Merchantile Exchange is the tide that
25 moves all hopes up or down. As that market moves,

1 since that market is the basis on which all people sell
2 cheese, if you can have a positive influence on that
3 market, you can have a positive influence on that
4 price.

5 And what I've got here on this map is a very
6 busy chart, but across the bottom of it are times from
7 January 5 to September 27. Up the left axis of this
8 chart are numbers that represent the number of loads of
9 cheese that were purchased on that day, 45,000 pounds,
10 40-pound blocks of cheddar cheese. On the right hand
11 axis of this graph are dollars per pound for a block,
12 40-pound block of cheddar cheese. The red line through
13 the middle is the price that occurred that day on the
14 CME. And the spikes at the bottom are -- indicate
15 whether DFA was a buyer or somebody else was a buyer.
16 So you can see when we went into this February 2 to
17 about the 26th of April we were not a buyer. We were
18 not in the market. We were not in the CME. We were
19 not involved. We did not put cheese to \$2.20 a pound
20 which is the peak that you see of that red line that
21 occurred there in April, the middle of April. The
22 market started to collapse. That company that moved
23 that market to 2.20 we think were Schreiber Foods.
24 Apparently they had missed their guesses on sales and
25 inventory, so they were in the market looking for

1 cheese to satisfy their customer needs with. And as
2 that market started to fall we interceded some. You
3 can see at the first level of \$2.00 we made a stand and
4 backed off. We did make a long significant stand at
5 1.80 a block. And you will note all along the bottom
6 the big spikes each day, we were the main buyer of
7 cheese on the CME trying to make a statement to the
8 trade that we thought 1.80 was about the right price
9 for 40-pound blocks of cheddar cheese. And notice on
10 one day, about the 7th of June, we, DFA, bought 52
11 loads of cheese on that market that day, a record
12 number of transaction. After we had bought the cheese
13 that we needed for our market, for our customers, for
14 our demand, we backed out, and when we did the market
15 you can see it fell to about 1.36. What we are trying
16 to show with this gray area in the middle is what
17 effect we had on milk prices as a result of that. I
18 would also call your attention to our activity since
19 about the 16th of August when that market fell and then
20 recovered some, and our sales improved. We needed
21 about another 100 loads of cheese. We were back in the
22 market holding that market roughly at 1.55. But our
23 guys have made some estimates of what that has meant to
24 you and to DFA members based on those months and based
25 on the difference between \$1.80 cheese and \$1.36

1 cheese, CME. Our estimate is that that action, our
2 planning and our ability to be a market maker, our
3 ability to buy cheese on the exchange for our customers
4 put \$1.3 billion in the dairy farmers' pockets, and to
5 the DFA members that was \$278 million, our estimate of
6 that activity. Our ability to be in the cheese
7 business, to be a market maker, and then to fulfill our
8 needs in the marketplace is what caused, what led to
9 that price enhancement. This is the market since we
10 stepped out. We quit buying on October the 4th, and
11 you can see that as a result of DFA not being there,
12 that market adjusted very significantly. That was
13 lately. Incidentally, it did go up today, 40-pound
14 blocks are up two, I believe, two and three-quarters
15 today.

16 The question is where will this market be,
17 is 1.35, 1.36 the right level. I don't know. You can
18 see the CWT trigger points 1.40 for 40-pound blocks of
19 cheddar cheese and I would guess that we have seen the
20 peak for this year at least for 40-pound blocks, and I
21 think you will see CWT kick in and start doing some
22 export of cheese. I was visiting with Jerry Kozak at
23 lunch today. We have between 12 and \$15 million left
24 in the CWT coffers to help with exports of cheese.

25 Part of the plan of DFA when our organizers

1 put it together was to put together facilities, plants,
2 some of which buy milk, some of which just use dairy
3 ingredients in the process. You saw Rick's map of
4 Dairylea's spattering around where their customers are.
5 These are our own either wholly owned or joint venture
6 locations of facilities. The green ones are those that
7 are balancing plants, plants that we have to run
8 because we have milk. Balance plants are those that
9 take surplus milk when the fluid market doesn't need it
10 and give it up when the demand in the marketplace is
11 there. Those are area council responsibilities. The
12 yellow spots that you see are the ones that we run
13 because we have a market for what they make, whether
14 that's American cheese, whether that's mozzarella
15 whether that's Frappachino, whether that's Enfamil.
16 The joint ventures are in red, and our joint ventures
17 are those that we have with Fonterra, those that we
18 have with Dean -- excuse me, with Hood, with MBH, with
19 Wilcox, with Stremik in California, with dairy farms in
20 the middle of the country. Those bottling plants that
21 we joint venture with others are now about 60 plants.
22 We have a joint venture with LOL. Jack Garrity will be
23 here with them on a cheese plant in Minnesota. We have
24 a joint venture with some butter operations with some
25 partners in Hotel R. Keller. We like joint ventures.

1 It let's us specialize in specific management for that
2 kind of an operation and it helps us leverage our
3 balance sheet. That DFA plant system was what our
4 organizers wanted, created so that they could be
5 involved in the markets across the United States on a
6 national basis.

7 Where are we going to be tomorrow. Well, we
8 said we needed to be in the export business. These are
9 the products that we have exported in the year '01,
10 '02, '03. We don't have '02 on here yet. I would say
11 that most of our nonfat domestically -- no, let me say
12 it a different way. All of the nonfat dry milk that we
13 produce, and we produce quite a bit in all of our
14 balancing plants, is sold through DairyAmerica, a
15 cooperative of cooperatives, a common marketing agency
16 for nonfat dry milk. And DairyAmerica has taken one
17 more step and they have said to Fonterra, this New
18 Zealand cooperative, you know how to market nonfat in
19 the world. If we get out there selling a dab of
20 nonfat, we are liable to screw up your major market
21 nonfat. Why don't you be our agent offshore and let's
22 create another common agency for our sales offshore.
23 And so not only are the cooperatives collectively using
24 DairyAmerica that sells together domestically, but we
25 are using Fonterra to sell internationally. And if you

1 talk to Rich Louis at DairyAmerica who is the manager
2 of DairyAmerica, he will tell you that he believes that
3 relationship with Fonterra offshore has meant at least
4 a nickel a hundredweight higher nonfat prices than if
5 we were out there doing it ourselves.

6 We are big business in export. Last year we
7 exported about \$64 million worth of products offshore.
8 Again remember when we said we were organizing a
9 company to get ourselves ready to be able to export or
10 be able to compete domestically. It doesn't mean we
11 are going to give up. We are still asking for some
12 regulations, tariff regulations, on a loophole in the
13 WTO agreement that we negotiated. A product called
14 milk protein concentrate wasn't even around when we
15 negotiated the deal and it is starting to roll in on an
16 increasing quantity. That's the one on the left you
17 see there. And casein, which is the one on the right
18 which is nothing more than the milk fraction of the
19 milk protein that you have in skim milk. We have not
20 been able to get the tariff commission or the commerce
21 commission to get that defined as a dairy product. It
22 is called a food ingredient, so there's no way under
23 present rules to put a quota on it. But we now have as
24 you can see 37 members of the Senate and 198 members of
25 the House who have agreed to co-sponsor this

1 legislation. And we are not asking for full total
2 elimination of this import. We are just asking for a
3 cap. Put a cap on it so it doesn't continue to grow or
4 sky rocket. You will see us continuing to partner not
5 only with you and Dairylea, but you will see us
6 partnering internationally with Fonterra, and I
7 mentioned a minute ago our chief plant in Clovis, New
8 Mexico, with a co-op out of Ireland called Glanbia.
9 You will see us partnering with processors where they
10 bring something unique to a business, either money or
11 management skills or technology. And we're even
12 partnering as you know, as Rick just said, with dairy
13 farmers who choose not to be a member of Dairylea or
14 St. Albans or DFA, but will allow us to market their
15 milk as it leaves their barn yard gate, which is what
16 is important. DFA also had a plan and still has a plan
17 to retire and return to members earnings and retains
18 that we have retained in their business. This is an
19 expression of those different kinds of equity
20 retirements since we started. If you total all those
21 bars up we have early equity retirement for age, we
22 have estate settlement for sure, we have tenure
23 certain, we have had an early equity retirement on a
24 good basis. We have lots of different kinds of equity
25 retirement. And since we started in 1998 we have

