

UNITED STATES DEPARTMENT OF AGRICULTURE
BEFORE THE SECRETARY OF AGRICULTURE

 In re:) Docket Nos.
 Milk in the Northeast,) AO-14-A78, AO-388-A23,
 Appalachian, Florida,) AO-356-A44, AO-366-A52,
 Southeast, Upper Midwest,) AO-361-A44, AO-313-A53,
 Central, Mideast, Pacific) AO-166-A73, AO-368-A40,
 Northwest, Southwest, and) AO-231-A72 and AO-271-A44,
 Arizona Marketing Areas) DA-09-02, AMS-DA-09-0007

- - -
 VOLUME IX
 - - -

Public Hearing

Before: Administrative Law Judge
 Jill S. Clifton

Date: May 14, 2009

Time: Commencing at 8:02 a.m.

Place: Westin Cincinnati Hotel
 21 East Fifth Street
 Cincinnati, Ohio 45202

Before: S. Diane Farrell, RMR, CRR
 Notary Public - State of Ohio

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1 JUDGE CLIFTON: We're back on record at
2 8:02. It's Thursday, May 14, 2009. We're in
3 Cincinnati, Ohio. And this is day 9 of the milk
4 rulemaking hearing. I'm Judge Jill Clifton,
5 U.S. Administrative Law Judge, and I'd like to
6 talk now about the schedule for tomorrow, and
7 Monday. Well, today, tomorrow and Monday.

8 As you know, we've been trying to confine
9 our hours to the core hours when we can. That
10 would mean today we'd go until 6:00. That's
11 probably our best course of action, unless we're
12 in the middle of a witness that we have a
13 reasonable expectation of finishing if we
14 continue after 6:00.

15 Now, tomorrow several of you have seized
16 upon my statement that I would guarantee that I
17 would be here until noon with the hope that that
18 meant that I would leave at noon. But that's
19 not my intention. My intention is if we've got
20 witnesses to hear, which obviously we do, we
21 should put in a full day.

22 Now, a full day on Friday means until
23 5:00. We have the room until 5:00. Is there
24 anyone who has any serious objection to us
25 working here in the hearing until 5:00 tomorrow?

1 No objection. No serious objection. I
2 appreciate that.

3 Then Monday, my belief is we should start
4 at 8:00. I realize that ruins your Sundays with
5 your family if you've gone home because you
6 spend Sunday getting back here. But I think we
7 should do it. I'm expecting that we won't need
8 all of next week. But I don't want to take any
9 chances, so I want to keep the pedal to the
10 metal until we finish. So that's why I would
11 like to start Monday at 8:00. But I will hear
12 you if you seriously request something different
13 from that.

14 Anyone? Mr. Vetne.

15 MR. VETNE: I, for one, will not be here
16 the full day on Friday, but my objection -- I'm
17 not sure if it would fall in your serious
18 category. It's personal.

19 And Monday, I assume that was an a
20 automobile reference. I think a bicycle on
21 Monday would be better. Just Monday, your
22 Honor, just Monday, 10:00? I will not get here
23 until Monday morning, so the -- I can get here
24 by midday from where I am, and the less I miss
25 probably the better. Because I'll be missing

1 most of Friday afternoon.

2 JUDGE CLIFTON: Mr. Vetne, you know
3 roughly the lineup and you know also that we
4 don't always finish each -- each day what we had
5 hoped to finish in a day. When do you think you
6 will testify? And do you have any estimate for
7 how long your direct would be?

8 MR. VETNE: My direct will be zero. I
9 intend -- I have authored and submitted two
10 letters with explanation to USDA supporting,
11 accompanying, and explaining the proposal by
12 Mallorie's, et al.

13 I know there are questions on how this
14 worked, what is meant and so forth, and intend
15 to make myself available to answer those
16 questions.

17 JUDGE CLIFTON: How soon can you
18 distribute your letters?

19 MR. VETNE: They've been distributed for
20 a couple of months. They're online. They're
21 the supporting -- the letters supporting the
22 proposals. Everybody has got a copy. If you
23 need more paper copy, I could kill a couple of
24 trees and distribute them. But they're there.
25 They've been there for a month or more.

1 JUDGE CLIFTON: Okay. So your purpose in
2 testifying is to have those marked as exhibits
3 and come in as exhibits?

4 MR. VETNE: So it's for -- yes, for
5 purposes of reference, here's the explanation
6 given, here's my analysis of how it fits in the
7 system, regulatory objectives, et cetera, yes.

8 JUDGE CLIFTON: And then to be available
9 for any questions of counsel?

10 MR. VETNE: Yes.

11 JUDGE CLIFTON: Or anybody else in the
12 room?

13 MR. VETNE: Anybody else. If there's a
14 question how this works and why it was assembled
15 this way. And so my -- my direct testimony
16 would be -- would be zero and my cross would
17 depend on how many -- how clear I was in putting
18 that together, because if it was absolutely
19 clear, there shouldn't be any questions.

20 JUDGE CLIFTON: But you wrote those
21 before we started this hearing. You have no
22 modification because of all the evidence
23 received?

24 MR. VETNE: It's not my modification to
25 make, but my clients have modified the proposal

1 in one respect and that is to establish a second
2 hard cap. There's a first hard cap on exempt
3 milk and the second hard cap that Mr. Flanagan
4 described on a larger size at which exempt --
5 the possibility of exempt milk will apply.

6 So that modification has already come in.
7 And if, in context, that requires some further
8 explanation in light of the supporting letters
9 to USDA, I will discuss that, too.

10 JUDGE CLIFTON: When did that
11 modification come in?

12 MR. VETNE: On the last paragraph of
13 Mr. Flanagan's written testimony.

14 JUDGE CLIFTON: Ah. So your -- your
15 documents don't encompass that but you are
16 relying on your client's documents to lead us
17 there?

18 MR. VETNE: Right, it's my clients'
19 proposals. My clients have modified it. And I
20 can explain how that fits in with the supporting
21 letters.

22 JUDGE CLIFTON: Sounds to me like you
23 either need to modify your letters or you need
24 to testify on direct.

25 MR. VETNE: Mr. Flanagan has already done

1 that. I will take care of it, your Honor --

2 JUDGE CLIFTON: Okay.

3 MR. VETNE: -- whatever is required.

4 JUDGE CLIFTON: Okay. Just don't --

5 don't use your documents to confuse us. You may
6 have to, I think, align them with your position.

7 MR. VETNE: My client's position, I --
8 you're right. Just to bring everybody up to
9 speed, I may take 60 or 90 seconds to refer back
10 to Mr. Flanagan's testimony and say, here's the
11 modification applied to these proposals.

12 JUDGE CLIFTON: Okay.

13 MR. VETNE: Thank you.

14 JUDGE CLIFTON: You're welcome.

15 Mr. English.

16 MR. ENGLISH: I just want to say, thank
17 you, Mr. Vetne.

18 JUDGE CLIFTON: Now, let me hear from
19 somebody else besides Mr. Vetne on how important
20 1:00 Monday is to you. And I should have asked
21 Mr. Vetne, but I'll ask you if you come to the
22 podium, when do you anticipate we'll finish if
23 we start at 1:00 on Monday? By finish, I don't
24 mean just Monday. I mean the whole thing.

25 MR. BESHORE: I think --

1 MR. YALE: Go ahead.

2 MR. BESHORE: No, you take a shot at it.

3 JUDGE CLIFTON: I'm glad you're a little
4 frightened to come up here and ask for this.
5 Mr. Yale.

6 MR. YALE: This may -- for some, may
7 think out of character. Of course, I have the
8 privilege of being somewhat nearby and would
9 just as soon get started Monday and get it over
10 with next week as opposed to take more days out
11 of the workweek; not that this isn't work, but
12 there's a lot of work waiting to get done.

13 I will share what I have listed just to
14 give you an idea of what I think is left to be
15 done. We have a cross of Yonkers, a cross of
16 Mr. Carman; not necessarily in this order but
17 Elvin Hollon, John Carroll, John Vetne,
18 Dr. Knutson, Dr. Knoblauch.

19 The testimony from -- that I think is
20 going to be next is from Braum's Dairy. I see a
21 Charles Sharpe, a Tim Butler, a Sally Keefe, a
22 Warren Taylor. Boyd, I don't know. There was a
23 question mark. It wouldn't be this week, but it
24 would come in next week, and this Dr. Orr and
25 rebuttal. Now --

1 JUDGE CLIFTON: Tell me again. After
2 Braum's, who was next?

3 MR. YALE: I had a Charles Sharpe was the
4 notes I had. Is that right? Yeah.

5 JUDGE CLIFTON: All right. Who did you
6 have next?

7 MR. YALE: Tim Butler.

8 MR. RICCIARDI: Button.

9 MR. YALE: Button. You know, my
10 handwriting is interpretable in many ways.

11 JUDGE CLIFTON: After Button?

12 MR. YALE: Sally Keefe.

13 JUDGE CLIFTON: Okay.

14 MR. YALE: And then Warren Taylor from
15 Snowville and Boyd from Colorado -- I don't
16 know; that's a question -- and this Dr. Orr or
17 whoever and any rebuttal.

18 So, you know -- you know, maybe --
19 maybe -- I'm not going to argue against myself.
20 It's very possible we could come in Monday and
21 be done Monday afternoon. But I would think
22 that if we started earlier on Monday, we have a
23 good shot of being done Monday, is my point.

24 JUDGE CLIFTON: All right.

25 MR. YALE: And maybe instead of 8:00 we

1 could do 9:00 or 10:00. But it looks like we're
2 close unless somebody has some major epiphanies
3 over the week and brings in boatloads of
4 rebuttal evidence which will make all of us
5 friends.

6 MR. BESHORE: For the list, Mr. Hollon
7 will testify in the rebuttal position, but -- I
8 discussed this with other folks here,
9 Mr. Ricciardi and Mr. Miltner. He hasn't
10 testified yet. Some of his testimony would be
11 just general supportive testimony. But he'll
12 also cover rebuttal, so he only comes up one
13 time.

14 JUDGE CLIFTON: Okay. Good. Do we know
15 when Dr. Orr will come?

16 MR. ROWER: She's asked --

17 JUDGE CLIFTON: Into the -- sorry.

18 MR. ROWER: She's asked that we let her
19 know when there's time available, but she can't
20 come later than Monday.

21 JUDGE CLIFTON: Okay. So let's ask her
22 to come Monday and let's ask her to come at
23 whatever time we decide we're going to start.

24 MR. ROWER: Okay.

25 JUDGE CLIFTON: She has a four-hour

1 drive. Maybe we shouldn't say what time we're
2 going to start. Maybe that's not a good idea.
3 Sorry. Let's just ask her to come Monday.

4 MR. ROWER: Okay. Thank you. We'll try
5 and get in touch with her.

6 JUDGE CLIFTON: Mr. Miltner.

7 MR. MILTNER: Your Honor, we do know
8 Messrs. Sharpe and Button will be available
9 Monday.

10 MR. BESHORE: Not tomorrow?

11 MR. MILTNER: No, not tomorrow.

12 JUDGE CLIFTON: Okay. Anyone else? Is
13 there anyone else who wants to be heard? Okay.
14 I'm going to leave it Monday. Is there any
15 chance that we could finish Monday? It's worth
16 it. It's worth putting in a full day. All
17 right. With apologies to Mr. Vetne.

18 Okay. So we go tomorrow from 8:00 to
19 5:00 and we go Monday beginning at 8:00 until we
20 finish the hearing, hopefully. And if anybody
21 expects to testify Tuesday, they may be
22 disappointed. We may not be here.

23 Is there anything else before we proceed
24 with testimony? If not, Mr. Bostwick may come
25 to the witness stand.

1 THE WITNESS: Good morning, your Honor.

2 JUDGE CLIFTON: Good morning. If you
3 would be seated, I'll swear you in in a seated
4 position, just so you're closer to the
5 microphone.

6 And when you state your name and spell it
7 for me, make sure you're about two inches from
8 this microphone.

9 THE WITNESS: Yes, ma'am.

10 JUDGE CLIFTON: Please state and spell
11 your name.

12 THE WITNESS: My name is W. Anthony
13 Bostwick. That last name is B-o-s-t-w-i-c-k.

14 JUDGE CLIFTON: Now, push your chair as
15 close as you can get it to the table. I know
16 those arms prevent it a little. And move the
17 microphone even closer to you. That's going to
18 work, I think.

19 THE WITNESS: Very well.

20 JUDGE CLIFTON: Would you raise your
21 right hand, please?

22 (The witness was sworn.)

23 JUDGE CLIFTON: Thank you. Mr. Ricciardi
24 you may proceed.

25 MR. RICCIARDI: Thank you, your Honor.

1 W. ANTHONY BOSTWICK
2 of lawful age, being duly sworn, was examined and
3 testified as follows:

4 DIRECT EXAMINATION

5 BY MR. RICCIARDI:

6 Q. Good morning. I am Al Ricciardi on
7 behalf of AIDA, and before we get into your statement,
8 Mr. Bostwick, can you tell us what position that you
9 currently hold at Braum's?

10 A. I'm the chief executive officer.

11 Q. And how long have you held that position?

12 A. Since 2001.

13 Q. Tell us what Braum's Ice Cream & Dairy
14 Stores are, please.

15 A. Well, it's -- I'd probably best describe
16 it as a classical vertical, in that we raise roughage
17 and we raise corn and we feed that to our cattle and
18 then we milk those cows.

19 We process the milk in our processing
20 plant. Then we put it in our trucks and ship it to our
21 retail stores, which is the only place we sell our
22 product, is in our retail stores in a five-state area
23 around Oklahoma.

24 Q. And you get into the details in your
25 statement, so I won't belabor it here. Just as an

1 introductory point, however, Braum's operates as a
2 producer-handler, is that correct?

3 A. Yes.

4 Q. How long has it operated under that
5 particular model?

6 A. Since 2001.

7 Q. Now, you have been authorized by Braum's
8 to prepare a statement to be given in this hearing, is
9 that correct?

10 A. Yes, that's correct.

11 Q. And your statement is prepared in
12 response to Proposals 1, 2 and 26, is that also correct?

13 A. As I understand it, yes.

14 Q. And also in support of Proposals 23, 24,
15 and 25?

16 A. Yes.

17 Q. Okay. And have you, in fact, prepared a
18 statement that has now been marked for identification --
19 you don't have the number in front of you, but I'll
20 represent it's Exhibit 87.

21 (Exhibit 87 was marked for
22 identification.)

23 A. Yes.

24 Q. Okay. And do you have that statement in
25 front of you, sir?

1 A. I do.

2 Q. Why don't you go ahead and proceed and
3 present that information now?

4 JUDGE CLIFTON: Move the microphone a
5 little to the left. You may have to move your
6 statement a little to the left as well and a
7 little closer to you.

8 THE WITNESS: How about this?

9 JUDGE CLIFTON: I think it'll work.

10 THE WITNESS: Okay. Correct me if --

11 JUDGE CLIFTON: See, you're going to look
12 down and read your statement.

13 THE WITNESS: Yes.

14 JUDGE CLIFTON: And so --

15 THE WITNESS: Oh.

16 JUDGE CLIFTON: And it changes the
17 positioning to the mic.

18 THE WITNESS: I see.

19 JUDGE CLIFTON: Okay. Go ahead.

20 A. My name is W. Anthony Bostwick. I go by
21 Tony. I am the chief executive officer of Braum's Ice
22 Cream & Dairy Stores in Oklahoma City. Braum's Dairy is
23 a vertically integrated, third generation company that's
24 owned 100 percent by the Braum family, and there are
25 four people named Braum.

1 We're in the Central Order. Braum's
2 Dairy has operated as a producer-handler since 2001.
3 Braum's sells all of its own dairy products in its own
4 retail stores. It does not carry any other fluid milk
5 brands. In addition to our farm and processing plants
6 we have retail outlets in five states, Oklahoma, Texas,
7 Arkansas, Kansas, and Missouri. These retail outlets
8 contain three different business areas; a quick service
9 restaurant with drive-thru windows, an ice cream parlor
10 we call our fountain, and a fresh market where fresh
11 dairy, bakery, meat, and produce items are sold.
12 Braum's is a member of the American Independent Dairy
13 Alliance and supports denial of the petitions to change
14 the existing status of producer-handlers.

15 Our marketing strategy is based on
16 quality, traceability, time to market, fresh --
17 freshness, and higher solid nonfats in lower fat milks.
18 Our lower fat milk products are unique. They contain a
19 higher solid nonfat percentage than other brands based
20 on a process through which we remove water. As a
21 result, it takes 3 gallons of milk to make every
22 2 gallons of Braum's fat-free milk with the remaining
23 water removed accounted for as Class IV milk. A variety
24 of doctors in our marketing area recommend our low-fat
25 mix to their patients who need the extra calcium with

1 less fat.

2 We consider our business to be consumer
3 oriented, niche market, and we -- and it's a price
4 follower. We do not have either a processor or retailer
5 competition in the market -- in marketing. Recently a
6 Kroger store near our McKinney, Texas store was selling
7 milk for \$2.79 for the store brand, and the generic
8 brand was \$1.99, even though each was bottled in the
9 same plant. We are not selling milk at retail to move
10 other products. We occasionally lose sales to
11 competitors like Kroger's when milk goes on sale, but
12 our customers are very loyal to our particular products.
13 Since we must self balance as a producer-handler, we
14 cannot go after someone's milk business. Our supply is
15 restricted -- is strictly limited to what we produce.
16 We do not view ourselves as price competitors at retail
17 and as I have said, our products are not available in
18 any other retail outlets other than our own, nor has
19 anyone asked us to begin supplying milk for their retail
20 operations. It's not what we do.

21 Braum's has grown with our customer base
22 during three generations of our existence. We milk
23 approximately 12,000 cows, and our Class I utilization
24 tends to be in the 50 plus range. Although we do not
25 purchase or sell any raw milk, we do on occasion

1 purchase or sell condensed skim, nonfat dry milk or
2 cream from other plants.

3 JUDGE CLIFTON: Let me stop you there.

4 We all knew what you meant, but when you said
5 that the utilization tends to be in the 50 plus
6 range, was that 50 plus percentage range?

7 THE WITNESS: It would be 50 or more.

8 JUDGE CLIFTON: Percent?

9 THE WITNESS: Yes.

10 JUDGE CLIFTON: Thank you.

11 A. Okay. Because of a higher percentage of
12 sales of lower fat milks and lower fat frozen yogurt and
13 sherbet products, we rarely need to produce additional
14 cream for our ice cream products. We do purchase butter
15 and cheese at the present time.

16 We do not view ourselves as the source of
17 any disruption in the market in any way. We value the
18 independence embodied in the producer-handler status
19 because it fits our business as well. Our reputation
20 with our customers depends on providing the consistent,
21 fresh, high quality milk that they expect in the Braum's
22 branded milk. Our milk is immediately chilled to
23 35 degrees Fahrenheit when it leaves the cow. It is
24 delivered to our bottling plant within 8 hours, and is
25 on the shelf in our stores within 36 hours. Our brand

1 is like a McDonald's type company in that our customer
2 expects a uniform, consistent product except in our case
3 they expect high quality as well. Braum's cannot depend
4 on pool milk to meet that standard. It is not uniform
5 quality with respect to freshness. And in short, based
6 on our quality profile, we cannot rely on pool milk.

7 As we understand the proposal to
8 eliminate producer-handler status, it is based on the
9 argument that producer-handler activity has become
10 disorderly marketing (whatever that means) for two
11 reasons. The first argument is that such conditions are
12 created by reductions in the blend price to folks who
13 are just producers created by producer-handler depooled
14 Class I volume activities. Second, the argument is made
15 that producer-handlers have an unfair price advantage
16 (the blend price versus the Class I price) over folks
17 who are just handlers (the wholesalers).

18 Now, let's look at the first part of
19 this. Does the depooling of the producer-handler
20 Class I volume reduce blend price to the producer in a
21 way that differs from other permissible activities in
22 the FMMO system?

23 We do not believe that is the case. A
24 lot has been said about the Central order in this
25 proceeding. The Central Order was greatly enlarged as a

1 result of Federal Order reform. It now includes many
2 large cheese processing plants. In 2008, the Central
3 Order data I received from our administrator showed that
4 a very large volume of Class III milk was depooled,
5 (removed from the pool) in each of 5 months when the
6 value of Class III milk exceeded the blend.

7 In March of 2008, over 240 million pounds
8 of Class III milk was depooled. In
9 May 302 million pounds of Class III milk was depooled.
10 In June of 2008, 246 million pounds of Class III milk
11 was depooled. In October of 2008 over
12 185 million pounds of Class III milk was depooled, and
13 in December, over 230 million pounds of Class III milk
14 was depooled.

15 JUDGE CLIFTON: Let me interrupt you
16 again. When this exhibit goes on the website,
17 would you like there to be a million inserted
18 between 185,000 and pounds?

19 THE WITNESS: Yes, ma'am, I would.

20 JUDGE CLIFTON: Or let's see.

21 THE WITNESS: It would be 185 million
22 pounds.

23 JUDGE CLIFTON: Rather than 185,000?

24 THE WITNESS: Yes.

25 JUDGE CLIFTON: So I'm going to ask

1 Ms. Fisher to make that correction and have you
2 initial it before you leave. So read the
3 sentence again the way it should be.

4 THE WITNESS: Yes, ma'am.

5 JUDGE CLIFTON: Slowly, please.

6 THE WITNESS: Yes, ma'am.

7 A. In October of 2008, over
8 185 million pounds of Class III milk was depooled.

9 THE WITNESS: Thank you, ma'am.

10 A. In December, over 230 million pounds of
11 Class III milk was we depooled. For all of 2008,
12 1.4 billion pounds of Class III milk was depooled in the
13 Central order. This compares with a total volume of
14 producer-handler sales for 2008 Central Order of
15 176.8 million pounds. That's 12 percent of the amount
16 of milk removed from pool -- from the pool by depooling.
17 And that number is -- 176 million is from the Exhibit
18 12. And putting my producer hat on, a reduction in
19 blend price is a reduction in blend price.

20 Second, we do not, as a producer-handler,
21 have an unfair price advantage over regulated handlers.
22 First, because we are independent, we get our milk at
23 the cost of production on the farm, not the price the
24 producer receives from the pool. And no one else is
25 producing or selling our brand -- our branded milk

1 products. As evident from the description above,
2 Braum's has a substantial investment in producing high
3 quality milk.

4 We estimate that full regulation would
5 add an additional regulatory cost to our business of --

6 THE WITNESS: And, ma'am, I need to add
7 \$300,000 there.

8 JUDGE CLIFTON: Okay. Good. We'll make
9 that correction as well. And you left out the
10 word annual when you read it the first time. So
11 if you would go back again.

12 THE WITNESS: Yes, ma'am, I will do that.

13 A. We estimate that full regulation would
14 add an annual regulatory cost to our business of
15 \$300,000 simply for administration oversight by the
16 Market Administrator, or as Drew Braum puts it, to
17 ensure he is paying himself the right amount for his own
18 milk. Due to the diversified nature of our business, we
19 do understand that diversified cooperatives and
20 processors can organize product -- production so as to
21 effectively eliminate the effect of any pool payment
22 obligation on their bottom lines or to become pool
23 neutral. While Class I fluid producers in the regulated
24 pool are required to pay in the pool --

25 JUDGE CLIFTON: I'm sorry. Start that

1 sentence again, please.

2 A. While Class I fluid producers --

3 JUDGE CLIFTON: Is it producers or -- are
4 you talking here about processors or producers?

5 THE WITNESS: It actually is --

6 JUDGE CLIFTON: Producers?

7 THE WITNESS: -- processors. It is.

8 It's proper. It's processors.

9 JUDGE CLIFTON: Oh, all right.

10 THE WITNESS: I read it incorrectly.

11 JUDGE CLIFTON: Read it from the
12 beginning.

13 THE WITNESS: Yes, ma'am.

14 A. While Class I fluid processors in the
15 regulated pool are required to pay into the pool,
16 Class III manufacturers draw from the pool. This is an
17 advantage of scale and diversification and it is not
18 available to most independent producer-handlers and to
19 us illustrates why producer-handlers cannot, as a
20 factual matter, be responsible for creating any
21 disruption in the national marketplace.

22 I would also like to point out that to
23 the extent its utilization matches the pool, a
24 producer-handler has no affect whatsoever on blend
25 price. Braum's is an example of this type of

1 producer-handler. If we were required to participate in
2 the pool, a very likely result could be an increase in
3 the blend price rather than an increase due to our
4 utilization of Class III milk, precisely the opposite
5 intent of the NMPF and the IDFA proposals.

6 We request that the petition to eliminate
7 producer-handler status be denied. In the alternative,
8 we support alternative 23, 24 and 25.

9 JUDGE CLIFTON: Very good. Thank you,
10 Mr. Bostwick. Mr. Ricciardi.

11 MR. RICCIARDI: Thank you, your Honor.
12 Just a few matters that I want to amplify from
13 the statement before I move the admission of the
14 exhibit and have Mr. Bostwick be questioned by
15 other people in the room.

16 BY MR. RICCIARDI:

17 Q. You talked a little bit about the
18 operation of Braum's since about 2001. How long has
19 Braum's actually been operating as a business?

20 A. In its form since 1967 and before that
21 back to the '30s.

22 Q. And it was started by the Braums family?

23 A. Yes.

24 Q. And in the '30s what type of operation
25 was it?

1 A. It was originally a butter wholesaler --
2 manufacturer and wholesaler. And then it morphed into
3 an ice cream business.

4 Q. So tell us about 1967. You said in its
5 current form. What form was Braum's operating at that
6 point?

7 A. At that point Mr. Bill Braum operated a
8 chain of Peter Pan Ice Cream & Dairy Stores in the
9 Kansas area. He sold those in '67 and then started
10 Braum Ice Cream Dairy Stores in '68 in Oklahoma City and
11 started a concept that was an old-fashioned dairy store
12 where you come in and get your milk. And he also added
13 the grill so that he could cook hamburgers. And he also
14 had a dipping operation, where you could make sundaes
15 and banana splits and those kinds of things.

16 Q. So if I walk into the Braum's store today
17 in any of their locations, as a customer, what can I
18 buy?

19 A. Well, you can buy your fresh perishables.
20 We view ourselves as a good fresh perishable stop. We
21 have --

22 Q. Let me stop you there. What do you mean?
23 Tell us specifically what types of things you sell.

24 A. Okay. In the fresh market you can find
25 our full line of dairy products, chocolate milk, orange

1 juice, bottled water, stack solids, ground beef in both
2 a modified atmosphere package and Chub. Find fresh
3 apples, oranges, bananas, strawberries, grapes,
4 potatoes, onions, really about anything that you would
5 expect to see in a fresh market or a farmer's market or
6 that part of the grocery store.

7 And then we have a -- our fountain area
8 where you can get dipped ice cream cones, malts, shakes,
9 like the old soda fountain thing. And we -- and we dip
10 a lot of ice cream. And we -- we make a lot of shakes.

11 And then we have what typically would be
12 a QSR, a quick service restaurant, similar to a Wendy's
13 or a Burger King with a drive-thru window. And we serve
14 breakfast and lunch there in that venue.

15 Q. So -- and all of the products that
16 Braum's sells are retailed at its own outlets?

17 A. Yes. We don't -- there are no Braum's
18 branding anywhere other than in a Braum's store, and we
19 do no manufacturing for anyone other than ourselves.

20 Q. So if I'm in a location and I want to
21 purchase Braum's Ice Cream, I've got to go to the retail
22 location?

23 A. Yes.

24 Q. One other point that I do want to talk
25 about with you for a moment before I move the

1 introduction of the statement. You said that as part of
2 being a producer-handler, that you are responsible for
3 producing all of the milk you use in the bottling plant
4 and bear the responsibility for managing the surplus.
5 How does Braum's Dairy handle its milk production? How
6 does it use it?

7 A. Our Class I utilization is fairly
8 constant throughout the year. Unfortunately, our
9 production is not. The cows don't produce evenly during
10 the year.

11 We are -- actually, my ice cream needs
12 actually are higher in the summer and lower in the
13 winter, which is just kind of the opposite of what my
14 cows think that they should give milk at. So I have to
15 balance into ice cream. So I'm able to make ice cream
16 year round. I vault that at minus 25 degrees; have to
17 have a large storage capacity for that ice cream. But
18 we make it into ice cream and then we pull out of that
19 ice cream in the summer where our needs are the highest.

20 Q. So if you have got a surplus, you put it
21 into ice cream and utilize it when it's necessary?

22 A. Yes.

23 MR. RICCIARDI: Okay. Your Honor, I
24 would move at this point the admission of
25 Exhibit 87 and sit down until redirect.

1 JUDGE CLIFTON: Thank you, Mr. Ricciardi.

2 Is there any objection to the admission into

3 evidence of Exhibit 8-7, 87? There is none.

4 Exhibit 87 is hereby admitted into evidence.

5 Who will begin cross-examination of

6 Mr. Bostwick? Mr. English. Thank you.

7 CROSS-EXAMINATION

8 BY MR. ENGLISH:

9 Q. Good morning, sir. My name is Charles
10 English.

11 A. Good morning.

12 Q. I represent a coalition of fluid
13 processors and trade associations of fluid processors,
14 largely subject to the pricing and pooling provisions of
15 the Federal Orders. I'd like to start by asking -- I
16 don't have a lot of questions.

17 Does Braum's sell all of its product
18 under the Braum's label?

19 A. No. There are a few items that are not
20 under the Braum's label. In the fresh market, for
21 example, our bag salads are Fresh Express. And we have
22 some cheese product that are manufactured by Belle
23 (phonetic) and their name is on that product. So not
24 everything is private labeled. But everything that we
25 make is Braum's labeled.

1 Q. Okay. And I apologize. I should have
2 been crisper with my question. It's a little early in
3 the morning, and we've been going a long time. How
4 about your fluid milk products, are they all sold under
5 the Braum's label?

6 A. Absolutely.

7 Q. Okay. And that's part of the point,
8 right? That's the quality product that you're putting
9 out there, correct?

10 A. Yes.

11 Q. Okay. And who is Drew Braum?

12 A. Drew Braum is Bill Braum's son. He's the
13 president of the company.

14 Q. Okay. And is it true that he's been
15 quoted in the newspaper recently about this proceeding?

16 A. I -- he probably has. I haven't read it.

17 Q. Okay. Do you know if it's the position
18 of Braum's Dairy that while you oppose this proceeding,
19 that you intend to do business as usual selling your
20 quality products?

21 A. That would be true.

22 Q. Who is Mr. DePee?

23 A. Mr. Who?

24 Q. Mr. DePee.

25 A. Al DePee?

1 Q. Yes.

2 A. He was our director of manufacturing.
3 He's since retired.

4 Q. Is his name spelled capital D, e, capital
5 P, e-e?

6 A. Yes.

7 Q. That's for the court reporter --

8 A. Okay.

9 Q. -- not for me. Are you aware that he
10 testified in a prior proceeding like this one in Arizona
11 in September of 2003?

12 A. I am aware of that.

13 Q. Okay. And are you aware that he stated
14 that the reason he was appearing -- even though your
15 operation wasn't in the Arizona or Pacific Northwest
16 orders, he stated, quote, I have reason to believe that
17 proposals are being formulated to change the
18 producer-handler language in all Federal Orders?

19 A. Yes.

20 MR. ENGLISH: I have no further
21 questions, your Honor.

22 JUDGE CLIFTON: Thank you, Mr. English.

23 Who will next cross-examine Mr. Bostwick?

24 Mr. Vetne.

25 CROSS-EXAMINATION

1 BY MR. VETNE:

2 Q. Good morning, Mr. Bostwick.

3 A. Good morning, sir.

4 Q. I'm John Vetne. I'm an attorney from New
5 Hampshire. My clients are producer-handlers in the
6 Pacific Northwest and in Arizona -- or, I'm sorry, New
7 Mexico.

8 You -- I'll try to go through in order
9 here. Your plant is located in Oklahoma, which is part
10 of the Central marketing area?

11 A. Yes, sir.

12 Q. And you have distribution into Texas,
13 which is the Southwest marketing area?

14 A. Yes.

15 Q. And you have distribution into Missouri,
16 parts of which are located in the Southeast marketing
17 area, correct?

18 A. I don't know.

19 Q. You don't know. Okay. Do you believe
20 that if -- if you were fully regulated, you would be --
21 be fully regulated as a pool plant in the Central
22 marketing area as opposed to some other marketing area?

23 A. I really don't have any idea.

24 Q. Would a -- would a plurality of your
25 fluid milk be in Oklahoma and Kansas?

1 A. It would be close to 50 percent --

2 Q. Okay.

3 A. -- I would think.

4 Q. I'm intrigued about your low fat -- lower
5 fat milk products. You remove water. Is that a reverse
6 osmosis process?

7 A. No, it's actually a -- it's -- we use a
8 vacuum pan and actually remove the water through a low
9 boil. When you take a liquid and put it under a vacuum,
10 it'll boil at a lower temperature. So you are able to
11 remove water at a very low temperature, the same method
12 as you would if you were boiling water or boiling milk.
13 You can remove the water. But it's a vacuum pan
14 process.

15 It's kind of an old technology. It used
16 to be used a lot, and Mr. Braum likes it and we're good
17 at it. But hardly anyone does it that way.

18 Q. It's the kind of process that Emeril, the
19 chef on TV, would refer to as reduction?

20 A. I don't know.

21 Q. You don't know?

22 A. No.

23 JUDGE CLIFTON: Now, if you are going to
24 use Emeril's name, you'll have to spell it.

25 MR. VETNE: E-m-e-r-i-l. I've got to be

1 careful what I refer to. I don't want to get
2 caught on the spelling error. I've done that
3 once.

4 BY MR. VETNE:

5 Q. The Central market in which your plant is
6 located in which you might be regulated if you were
7 pooled, is that what's called a component pricing market
8 for producer milk?

9 A. You know, I don't know that either.

10 Q. You don't know that either. So when you
11 say that the -- the gallon that's removed in this low
12 boil is accounted for at Class IV --

13 A. Yes.

14 Q. -- to whom did you account for it at
15 Class IV?

16 A. Oh. We're required in the Central Order
17 to report as if we were regulated. And so we do report,
18 but we -- that's all we do, is report.

19 Q. So you show how you use your milk?

20 A. Yes. We're required to report our
21 utilization, every month.

22 Q. Okay. Would it be true that the water --
23 the gallon that's removed has very little milk solids
24 either --

25 A. It wouldn't have any milk solids.

1 It's -- it's distilled water.

2 Q. Yes.

3 A. There's nothing -- there really wouldn't
4 be any solids or anything like that in there. It's
5 going to be pure water.

6 Q. So if -- do you know -- do you know what
7 a component pricing system is?

8 A. Yes. Yes, I do. I -- just -- maybe this
9 will help you ask me questions. I really didn't know
10 much of anything about milk market administration until
11 about January.

12 And I've been trying to get up to speed
13 as to what it is and what it means to us. So I've heard
14 that term and I know that it affects how you price the
15 fat separately and the solids separately. But I
16 don't -- I can't -- I can't sit here and probably
17 describe it or answer too many questions about it.

18 Q. And that's good. I am in awe at how
19 quick a study you are only since January. Do you
20 promote your lower fat milk products as being higher in
21 solids?

22 A. Oh, absolutely.

23 Q. By that, does that mean, you know,
24 compare our lower fat milk to regular lower fat milk?

25 A. Yes. As a matter of fact, we do a lot of

1 encouraging of people to test our fat free milk against
2 grocery store milk, and I point out that there's
3 50 percent more calcium.

4 So particularly people that are concerned
5 about bone density and things of that nature, but yet
6 they don't want the fat from whole milk, and they don't
7 want to have to drink 3 gallons instead of 2 gallons of
8 skim milk, then they'll buy my fat free milk. And we do
9 make a big deal about that.

10 Q. When -- interesting. When you sell
11 2 percent reduced fat milk, that's -- 2 percent is
12 called reduced fat --

13 A. Yes.

14 Q. -- rather than low fat, right?

15 A. Yes, yes.

16 Q. When you sell 2 percent reduced fat milk,
17 is the 2 percent of fat in that milk a fat percentage to
18 what's in the package or a fat percentage to what was in
19 the milk before you removed the water?

20 A. Oh, no, no, no. We -- we -- we remove
21 all the fat and we remove the water. And then we put
22 the fat back in.

23 Q. So you put the fat back in, and this is a
24 percentage of what's in the package?

25 A. Yes. The only thing -- the only thing

1 that's not what you would expect, I guess, in a
2 2 percent, 1 percent, it would be the nonfat solids.
3 Everything else would be what you would expect.

4 Q. So the fat to solids ratio in your
5 product is different -- in 2 percent than the fat to
6 solids ratio in regular 2 percent milk?

7 A. Yes. A good way to think about that is
8 we're using the solids to make up for the fat that we
9 removed so that the product will still have a good
10 texture, that it'll have a good mouth feel and people
11 will drink it. Because they typically like whole milk
12 and they don't like the lower fat milks. And in our
13 products, they have a very similar taste profile
14 throughout the fat line.

15 Q. All right. Your Class I utilization
16 tends to be in the 50 percent plus range. Does that
17 mean your Class I use is generally -- I assume is
18 generally more than 50 percent?

19 A. It was intended to be a little vague in
20 the statement.

21 Q. Okay. Can I ask you to be -- provide a
22 little bit more information? Your tendency, is there a
23 range from X percent to X percent or not?

24 A. Well, again, as we said, my Class I
25 utilization tends to be fairly flat. But my

1 manufacturing -- excuse me, my -- my production from the
2 cows is not. So it would probably be a little
3 misleading for me to say that my -- my utilization
4 varies because of my -- my sales. It varies because of
5 my milk that I need to process through my plant.

6 Q. I understand that absolutely clearly.

7 A. Okay.

8 Q. So my question is, your Class I use as a
9 percent of production on a monthly basis during the
10 course of the year will ordinarily range from X percent
11 to X percent, understanding that your Class I volume is
12 relatively flat. Is there a ballpark range, Class I --

13 A. There's not one I'd really like to share.

14 Q. You, on occasion, purchase or sell
15 condensed skim nonfat dry milk or cream. First of all,
16 condensed skim --

17 A. There should be a comma there.

18 Q. There should be a comma. There's no
19 product called condensed skim nonfat dry milk. Or,
20 actually, there may be --

21 A. I think there is. But it's redundant.

22 Q. Let's see here. Okay. Do you make
23 condensed skim that you sell?

24 A. No, not that we -- retail?

25 Q. Does your plant, from your farm milk?

1 A. Oh, I see. No. It's easier to transport
2 if you go ahead and condense it. You can get a lot more
3 in a tanker if you remove water before you sell it.

4 Q. So my question is, does Braum's remove
5 water from its own-farm milk and in turn sell it to
6 third parties?

7 A. Only when we run into this situation
8 where occasionally -- and, again, the only time that
9 should happen is when somebody screws up.

10 Q. This situation, meaning that you have
11 more milk produced on a given day or week than you can
12 possibly use?

13 A. Right. If I can't put it into ice cream
14 and I can't bottle it and I can't do anything with it.
15 So I can't process and sell it, but I can't manufacture
16 it.

17 Q. All right. So on those occasions, you
18 remove some of the water and sell to third parties as
19 condensed skim milk?

20 A. Yes.

21 Q. On those occasions -- do you have a
22 tanker truck of your own that you use for that purpose,
23 to transport it?

24 A. Yes, we have a typical tanker truck,
25 6,000 gallon. And we have a 12,000 that's -- that's too

1 large for the road that we use on the farm to move the
2 milk from the -- from the milking barn to -- to the
3 plant.

4 Q. To what type of milk plant customer do
5 you market condensed skim when you make condensed skim?

6 A. Again, I'm not sure that I market it;
7 what I call in desperation trying to find somebody to
8 take it. It's typically a Class II plant.

9 Q. Do you know whether the Class II plants
10 to which you typically sell your condensed skim milk are
11 or are not categorized as pool plants?

12 A. My guess, that they would not be pool
13 plants.

14 Q. Okay. Are those Class II manufacturing
15 plants all located pretty close to yours or are they in
16 a variety of geographic areas?

17 A. You know, I don't know the answer to
18 that.

19 Q. Do you know whether your condensed skim,
20 when you sell it, it goes north as well as south, east
21 as well as west?

22 A. I think most of it is close. Whether or
23 not it's -- how close or which direction, I -- I don't
24 know.

25 Q. Okay. With respect to nonfat dry milk,

1 does Braum's dry and powder its own milk?

2 A. No, actually, and I -- I don't.
3 Occasionally, I will buy some of that.

4 Q. Okay. So the sentence referring to
5 purchase or sell with respect to nonfat dry milk, you do
6 not make and sell your own nonfat dry milk?

7 A. Right. It's I make and sell or I buy and
8 sell these -- these items, not necessarily buy all of
9 them and sell all of them.

10 Q. Do you sell nonfat dry milk?

11 A. No.

12 Q. The purchase and sale clause preceding
13 all of these, nonfat dry milk is the only one that you
14 do not sell? You purchase or sell condensed skim and
15 you purchase or sell cream?

16 A. Over a long period of time that would be
17 true. I'm trying to remember the last time we bought
18 cream. I have bought cream, so -- but it's probably
19 been years.

20 Q. Cream is something, however, that you do
21 produce in your system from your own milk, and you have
22 the opportunity to sell if you have excess?

23 A. Well, generally I use all my cream.

24 Q. I understand.

25 A. Okay.

1 Q. But you make cream, and if somebody
2 wanted it and paid enough, you would -- at least it
3 would be available to sell?

4 A. Retail?

5 Q. No, bulk.

6 A. No. I can't imagine that -- unless I
7 just happen to make a mistake and end up with too much
8 cream, I wouldn't sell cream. I would -- I would make
9 ice cream with it.

10 Q. All right. On page 2 you talk about
11 depooling, and I think you're the first witness that has
12 referred to the nonpooling of producer-handler Class I
13 milk as depooling.

14 A. Well, that probably comes from my lack of
15 experience with the terminology that most of you know
16 better than I do. So I appreciate the schooling on
17 that. That may not be appropriate.

18 Q. I understand what you meant there. With
19 respect to your producer-handler Class I milk, you
20 intended the word, depooling, to mean milk that is not
21 included in the pool?

22 A. Yes.

23 Q. You did not intend with respect to your
24 producer-handler Class I milk to mean milk that goes in
25 the pool and comes out of the pool on a monthly basis

1 depending on arbitrage opportunities?

2 A. Oh, that would most assuredly be the
3 truth, yeah.

4 Q. And with respect to your discussion of
5 Class III milk, you -- however, you did intend, in your
6 reference to depooling, to refer to milk that moves into
7 the pool or out of the pool, depending on the
8 opportunity to make money?

9 A. As I understand it.

10 Q. As you have learned since January?

11 A. Yes.

12 Q. In the last paragraph, you are referring
13 to some differences between your operation and that of
14 other processors. And let me see if I understand some
15 of those differences. You receive milk at cost of
16 production on your farm, not the price producers receive
17 from the pool?

18 JUDGE CLIFTON: Comma, is that correct?

19 Was that a question? Or --

20 MR. VETNE: It's the beginning of a
21 question.

22 JUDGE CLIFTON: Okay. All right.

23 BY MR. VETNE:

24 Q. My question there is, as a handler,
25 you're receiving milk at whatever your farm segment of

1 your operation costs, but other -- well, let me start
2 there. The cost to your plant enterprise for milk is
3 the cost that your farm enterprise produces milk for?

4 A. Well, since I sell all the way through to
5 the retail, the varying -- my cost at -- to the retail
6 operation is what it costs me to produce it. And so at
7 the various stages of -- you know, producing and
8 processing and then retailing ---

9 Q. Let me stop you right there --

10 A. Okay.

11 Q. -- because I don't want to lose that.

12 The cost to your retail operation is the cost to
13 produce. And by cost to produce it, you are referring
14 to what producing activity?

15 A. Let me -- let me say first to process
16 from the -- from the milking operation. I think that's
17 probably the proper term.

18 Q. The farm operation?

19 A. Yes. And then the value added, the
20 manufacturing point, the handler, I guess, so those
21 costs billed for me. I have a certain amount of cost in
22 produce -- yeah, in producing the milk. And then I have
23 a cost in processing the milk, which I guess is a
24 handler cost. And then I, of course, have the cost of
25 getting it to my retail outlets and obviously selling

1 it.

2 Q. And then the retail overhead in your
3 stores?

4 A. Yes, that's true.

5 Q. So you have three -- three points at
6 which other enterprises have costs and markups. One at
7 the farm, one at the processing plant and one in the
8 stores?

9 A. Yes.

10 Q. To the extent that there are processing
11 handlers that want to compare -- fully regulated
12 processing handlers that want to compare their risks and
13 operations and costs with yours, one of the risks that
14 your operations has in its enterprise is all of the
15 risks at the farm level. A processor that only buys
16 milk does not have farm level risk, is that correct? It
17 just has a price that it pays?

18 A. Well, I believe that -- that's true.
19 Handlers have risks that farmers don't have. And
20 farmers have risks that handlers don't have. So they
21 both have risk. A producer-handler has all the risks.
22 And I have the retail risk.

23 Q. At the top of the last page you refer to
24 you estimate that full regulation would add an annual
25 regulatory cost, you inserted, of \$300,000 to our

1 business, simply for administrative oversight by the
2 Market Administrator. That \$300,000 is a reference to
3 what charge by the Market Administrator? Would that be
4 the administrative order assessment of a nickel?

5 A. And the 6 cent fee.

6 Q. Okay. So there would be a nickel charged
7 per hundredweight that you are not now paying --

8 A. Right.

9 Q. -- to administer the order to, among
10 other things, audit your books and records, which is a
11 big part of administration, to make sure that Braum's
12 plant is paying the right amount of money to the Braum's
13 farm?

14 A. That's correct.

15 Q. Okay. And there's another assessment
16 called marketing services --

17 A. Yes.

18 Q. -- which is charged for independent milk.
19 Processors that receive independent milk are charged so
20 that the Market Administrator is reimbursed for the
21 costs of comparing tests to make sure that the producer
22 is paid for the right test, and that the components are
23 properly tested, is that --

24 A. And my understanding is I would be
25 subject to both of those.

1 Q. So you would be charged as a handler for
2 the service of making sure that you, as a producer, are
3 paid on the right tests and components?

4 A. Yeah. It would make sure that I'm paying
5 myself for the right component pieces, yes.

6 Q. Okay. I love the irony of your statement
7 there. Towards the end you refer to the extent the
8 plant's utilization matches a pool, you have no effect
9 on the blend price?

10 A. Again, as I understand it.

11 Q. Okay. The pool, however, that you are
12 referring to is the Central market pool?

13 A. As I understand it.

14 MR. VETNE: Yes. You are an excellent
15 student, Mr. Bostwick. Thank you very much.

16 THE WITNESS: Thank you, sir.

17 JUDGE CLIFTON: Thank you, Mr. Vetne.

18 Mr. Beshore.

19 CROSS-EXAMINATION

20 BY MR. BESHORE:

21 Q. Good morning, Mr. Bostwick. My name is
22 Marvin Beshore. I represent the National Milk Producers
23 Federation and Dairy Farmers of America.

24 A. Good morning, sir.

25 Q. I have just a couple of questions for

1 you. Your statement in 87, you say at the very
2 beginning that you have been a producer-handler since
3 2001?

4 A. Yes.

5 Q. And I'm wondering what that means. Were
6 you not a producer-handler before 2001?

7 A. My understanding was that we were a
8 regulated plant before 2001. And we were paying into
9 the pool and receiving payments out of the pool on a
10 monthly basis.

11 Q. And in 2001 then you, what, applied for
12 producer-handler status?

13 A. And, again, I guess I don't exactly know
14 what the process was. But I know on January of 2001, we
15 continued to report, but we no longer were participating
16 in the pool.

17 Q. Okay.

18 A. And we were no longer able to buy the
19 milk and -- from the pool and those things. But, again,
20 I don't know a lot about that.

21 Q. Okay. I'm interested in just -- just a
22 couple of questions about Braum's business structure, if
23 you will.

24 A. Yes, sir.

25 Q. And you say you are the CEO of Braum's

1 Ice Cream & Dairy Stores, which you don't identify as a
2 corporation or an LLC. Is that a corporation? Is that
3 the corporate name?

4 A. It's a d/b/a, kind of the family
5 business.

6 Q. Okay. So what is the legal entity for
7 which you are the CEO?

8 A. Actually, the legal entity is Braum's,
9 Inc.

10 Q. Okay. And what operations are within the
11 corporate operations of Braum's, Inc.?

12 A. The retail operations.

13 Q. Okay. How about the plant operations?

14 A. The plant operations are in W. H. Braum,
15 Inc.

16 Q. So there's a separate corporation called
17 W. H. Braum, Inc.?

18 A. Right. It's an affiliated. They're all
19 owned the same percentages by the same people. Because
20 we're an S corporation it's difficult to have a holding
21 company. So the corporations are owned by the same four
22 people.

23 Q. And then what about the farm operations?

24 A. It's actually in another S corporation
25 called Whb Company.

1 Q. Whb Company?

2 A. Yes.

3 Q. Okay. Now, do you as CEO -- are you CEO
4 over the total complex?

5 A. Under the umbrella of Braum's Ice Cream
6 Stores Inc. umbrella, but --

7 Q. Is the umbrella for all those various S
8 corporations?

9 A. Yes, and LLC and LPs and on it goes.

10 Q. Okay. And how many separate business
11 entities are there that you -- in the family of
12 companies that you are the CEO for?

13 A. Well, it might seem larger than it really
14 is. There are seven. One is a grain supply company
15 that operates a couple of retail grain elevators and
16 that type of thing to support the local communities.
17 There's a transportation company that's in a separate
18 company. And there's an intellectual property company
19 that owns trademarks and licenses and that type of
20 thing. There's a real estate holding company that owns
21 real estate. So it's a more complicated than it
22 probably needs to be.

23 Q. Now, I noted on your -- just pursuing
24 your website a little bit that you have approximately
25 275 retail stores?

1 A. Yes, sir.

2 Q. Okay. And are they organized as straight
3 LLCs or S corps or C corps or are they one --

4 A. They actually are not. They are all
5 actually today -- we probably need to do that. But
6 today they are all under the Braum's, Inc. corp.
7 They're operated under that company.

8 Q. Okay. Now, when you -- since you have
9 separate corporations there, obviously you've got --
10 your financial operations involve transactions from
11 company to company?

12 A. Sure.

13 Q. When you're transacting a business from a
14 plant to the stores, you invoice fluid milk products at
15 some amount, I assume?

16 A. Well, there's actually not an invoice.

17 JUDGE CLIFTON: Mr. Ricciardi.

18 MR. RICCIARDI: Well, I've been letting
19 this go without getting up here. But it seems
20 to me that we are getting into specific
21 information that is confidential about this
22 business that is not related to anything in this
23 proceeding.

24 So two things. I think it's
25 confidential, number one. Number two, I think

1 it's irrelevant for the proceeding.

2 JUDGE CLIFTON: Mr. Ricciardi, before you
3 leave, are the documents with -- with regard to
4 these companies filed with the Secretary of
5 State?

6 MR. RICCIARDI: I would assume, your
7 Honor, to the extent that they're required to be
8 filed that they would be filed with either the
9 recorder's office or the Secretary of State's
10 office in those particular areas.

11 JUDGE CLIFTON: All right. So I think
12 your concern is not so much confidentiality but
13 relevance?

14 MR. RICCIARDI: It's both.

15 JUDGE CLIFTON: It's both?

16 MR. RICCIARDI: (Nodding head.)

17 JUDGE CLIFTON: Okay. Mr. Beshore, your
18 response.

19 MR. BESHORE: I just asked him a
20 question, which was essentially how the
21 transaction from the plant corporation to the
22 stores in terms of the fluid milk products, how
23 that was priced.

24 JUDGE CLIFTON: Well, no, you asked --

25 MR. BESHORE: I think that's

1 self-evidently relevant.

2 JUDGE CLIFTON: Your question was, was
3 there an invoice, and he said no. That was your
4 question.

5 MR. BESHORE: That is correct, your
6 Honor. What I was getting to was how it was
7 priced, which I think is self-evidently
8 relevant.

9 JUDGE CLIFTON: Mr. Ricciardi, you have
10 an objection to that question?

11 MR. RICCIARDI: I sure would. We
12 certainly are getting into confidential
13 information. Do we want to bring Dairy Farmers
14 of America, talk about its holding companies,
15 talk about how it does business? I would have
16 Mr. Beshore at my left shoulder very quickly.
17 Therefore, getting into these details when it is
18 unnecessary is simply trying to probe into
19 confidential information for no basis.

20 JUDGE CLIFTON: Thank you. Let me hear
21 from Mr. Vetne, Mr. Beshore, before I --

22 MR. VETNE: Your Honor, I absolutely
23 agree with Mr. Beshore and disagree with
24 Mr. Ricciardi. As you will recall, the clients
25 that I represent put on testimony and put on a

1 lot of detail about their business of the kind
2 for which others have raised confidential
3 questions. The confidentiality or proprietary
4 information is not -- is not in and of itself a
5 recognized legal objection. A witness can
6 disclose as much as he or she wishes about their
7 company. How much he or she discloses adds to
8 credibility, subtracts from credibility,
9 reliability or nonreliability of the
10 conclusions.

11 The how it's invoiced is -- is -- you
12 know, is not a question to ask what the price
13 is. And if we are going to get -- if a witness
14 such as this -- unfortunately, the less
15 disclosed about the transaction, the less the
16 Secretary has to work with, the less the
17 Secretary has to test the credibility of
18 assertions of the proponent in the first
19 instance on competitive disadvantage of
20 producer-handlers. And on the opponent side,
21 oh, we don't -- we're not a problem. You can't
22 judge either unless you have some of the core
23 data, and without the core data all you have are
24 conclusions, and conclusions is not substantial
25 record evidence.

1 So I think -- I think the question was
2 good. I don't think that the objection is
3 well-founded. I do think that the witness,
4 because we don't have a compulsory process, can
5 refuse to answer any question. And when a
6 witness refuses to answer questions, that
7 witness' credibility is reduced. That's it.

8 JUDGE CLIFTON: Mr. English.

9 MR. ENGLISH: Charles English. Your
10 Honor, although it may be the case -- I'm not
11 100 percent sure -- it may be the case that the
12 relevancy objection has been dropped.

13 I do want to note that 48 hours ago or 72
14 hours ago when I objected as to relevance, the
15 response from counsel for this witness was that
16 cross-examination should be unfettered. And
17 while I agree that it should not be -- I
18 disagree. I think it should not be unfettered.
19 I think this cross-examination is fettered.

20 I think the relevance piece was not well
21 taken, especially given what's gone on before.

22 JUDGE CLIFTON: All right. Thank you.
23 Mr. Beshore, do you want to be heard before I
24 rule?

25 MR. BESHORE: No.

1 JUDGE CLIFTON: All right. It's
2 perfectly legitimate for everyone in the room to
3 want to know the financial workings. It is also
4 acceptable if you do not want to disclose it. I
5 agree with Mr. Vetne, the more that it is
6 disclosed, the more everyone can get a handle on
7 whether the privilege of not paying into the
8 pool in Braum's case is disruptive.

9 So -- so you've pointed out that you
10 don't think it is.

11 THE WITNESS: (Nodding head.)

12 JUDGE CLIFTON: And you've pointed out
13 that you endure risk in every side of your
14 operation. But these numbers of how much does
15 it cost to produce milk, how much does it cost
16 to process it and the like are of interest to
17 the people here. That does not require you to
18 disclose them.

19 Mr. Beshore, you may ask your next
20 question.

21 BY MR. BESHORE:

22 Q. I think you told me, Mr. Bostwick, that
23 you don't actually invoice the products from the plant
24 to the stores. Did I understand you correctly?

25 A. That's correct.

1 Q. Okay. How do you show the cost of the
2 product from -- in the stores that are acquired from a
3 plant? Fluid milk products is all I'm talking about.

4 A. It's very similar to the way intercompany
5 transfers would be handled if they're all under one
6 company. Since they're all under the same control, the
7 same shareholders, then the functioning of the
8 transaction is really as if they were all in one
9 company. So it'd be if -- if a plant -- if a Dean
10 Foods, or anyone else, is transacting business within
11 the same company, they would not send the invoices
12 across the hall to one another and that type of thing.
13 They would just simply have due to/due from accounts and
14 settle up from time to time.

15 Q. Okay. But there would have to be a
16 dollar figure reflected on the books of one of the
17 selling entity and the buying entity, would there not?

18 A. Sure. There's also a transfer price of
19 some type.

20 Q. Okay. And that transfer price, is it,
21 you know, like one flat annual price or does it vary
22 monthly for fluid milk products from the plant stores?

23 A. Oh, I understand what you're asking.
24 It's set by Bill Braum.

25 Q. Okay. And are there any reference points

1 of which you're aware?

2 A. Not that I've been able to find.

3 Q. Does it vary --

4 A. He tells me what the price is and that's
5 what we transfer it at. There's really not much reason
6 to do a lot of internal accounting there. Because
7 again, as I said before, you've got the -- you've got
8 the cost of -- my cost at retail is what all my
9 cumulative costs were to get it there.

10 And while they're separate, they're all
11 in the same control group, so it really doesn't make any
12 difference where that money is made.

13 Q. Okay. Is there a transfer price from the
14 farm corporation to the plant corporation on the raw
15 milk?

16 A. It's set by Mr. Bill Braum.

17 Q. Okay. And does that change from month to
18 month?

19 A. It changes. I'm not sure that I would
20 characterize it as month-to-month --

21 Q. Are you aware of how it's set or on what
22 basis it's set?

23 A. -- he -- it's based on what he thinks it
24 should be. I wished I had more visibility into -- he's
25 a brilliant man. I wished I had more visibility into

1 how he actually comes up with some of the numbers, but I
2 don't.

3 Q. Do you actually run P&Ls --

4 A. Yes.

5 Q. -- for the separate corporations?

6 A. Oh, yes.

7 Q. And they're based on the transfer price
8 in and out?

9 A. Right. Again, since they're S corps, all
10 the -- all the revenue flows up with the shareholders,
11 unlike a C corp that would be taxed at that corporate
12 level. That's why it doesn't matter what those are.

13 Q. Since it doesn't matter -- ultimately
14 matter for tax purposes?

15 A. No, it doesn't because they -- as I said
16 before, it's like partners. If you had a loss in a
17 partnership and a gain in this partnership, they both
18 flow up to the shareholder or the partnership. And it
19 wouldn't make a difference which one of those had the
20 gain and which one had the loss.

21 Q. The transfer prices are important,
22 however, for internal management purposes in terms of
23 evaluating how the separate operating entities are
24 operating?

25 A. Yes, based on how -- the measuring stick

1 Mr. Braum's wishes to apply.

2 Q. Right. Okay. Typically with the
3 measuring sticks he applies are you profitable at each
4 level?

5 A. Not always.

6 Q. The \$300,000 estimated cost, if I
7 understood your responses to Mr. Vetne, that was based
8 on the assumption that Braum's would have to pay a 5
9 cent administration fee and a 6 cent nonmember milk fee
10 per hundredweight? Is that your understanding?

11 A. That's my understanding. And again, I --
12 that's my understanding, yes, sir.

13 Q. And that figure was provided to you by
14 whom?

15 A. That -- the Central Administrator.

16 MR. BESHORE: Thank you.

17 JUDGE CLIFTON: Just so I'm clear, that's
18 the Central Order Market Administrator gave you
19 that number?

20 THE WITNESS: Yes.

21 JUDGE CLIFTON: Based on the reports that
22 you had been filing or did you give the Market
23 Administrator some figures to work with to
24 calculate that for you?

25 THE WITNESS: No, no. He has all of our

1 numbers on a monthly basis.

2 MR. BESHORE: Thank you very much,
3 Mr. Bostwick.

4 JUDGE CLIFTON: Thank you, Mr. Beshore.
5 Is there any other cross-examination of this
6 witness? Mr. Carroll.

7 CROSS-EXAMINATION

8 BY MR. CARROLL:

9 Q. Good morning, sir.

10 A. Good morning, sir. How are you?

11 Q. Fine, thank you.

12 A. Good.

13 Q. I'm John Benjamin Carroll. I represent
14 the New England Milk Producers Association and two
15 additional producer-handlers in Order Number 1. They
16 live in Vermont and in Connecticut.

17 A. Oh, pleased to meet you.

18 Q. And some of them have been in business
19 even longer than you.

20 A. Oh, my.

21 Q. First of all, before I ask you any
22 questions, I want to join with the others who have
23 complimented you on this statement. It's short, it's to
24 the point, there are bullet points, and I think you've
25 managed to come to the heart of the issues that are

1 involved in this proceeding. And that's why I consider
2 you a very important witness.

3 If you turn to the last page of your
4 statement, and I'm going to direct your attention to the
5 first paragraph. And skipping the first sentence and
6 going to the second, you state, due to the diversified
7 nature of our business, we do understand that
8 diversified cooperatives and processors can organize
9 production so as to effectively eliminate the effect of
10 any pool payment obligations on their bottom line - or
11 to become pool neutral.

12 Directing your attention to that
13 sentence, I want to ask you if you can tell me what you
14 mean by that sentence.

15 A. Again, as I understand it, the -- if you
16 manage your production in such a way to bottle to where
17 you -- you -- you're not a regulated plant or to depool
18 cheese, excuse me, Class III, when it's favorable to do
19 so based on price, and to manage your production
20 schedules, which I do. I manage my production schedule.
21 I make more ice cream when I have too much milk.

22 When you have the ability to do that,
23 then you have much more opportunity to be pool neutral.
24 As in my case, I make a lot of ice cream. If I were to
25 be something other than pool neutral, I would probably

1 have the ability to -- to get pool neutral. Because
2 I've got a diversified offering. And the larger
3 companies and cooperatives are similarly situated, I
4 believe.

5 Q. Is it practical for the small processor,
6 producer-handler processor, to engage in that kind of
7 balancing activity, or is he pretty much confined to the
8 Class I market because of his size?

9 A. You know, I don't know the answer to
10 that. All I do know is it's a lot easier for me because
11 I'm a retailer.

12 Q. Now, directing your attention to the next
13 sentence, it says, while Class I fluid processors in the
14 regulated pool are required to pay into the pool, Class
15 III manufacturers withdraw from the pool. Could you
16 explain that sentence?

17 A. I can't explain the reason why. It
18 doesn't make any sense to me. Milk -- but -- but, as I
19 understand it, of course, Class I prices generally,
20 though not always, but are generally higher than
21 Class III. And Class I is generally higher than blend
22 where Class III is generally lower than blend, although
23 not always.

24 And so generally speaking, if you are a
25 Class I utilizer, you will pay a higher price than the

1 blend. And that's the way I understand it, is really
2 the -- the heart of what the pool is, is the blend.

3 And then if you're above the blend, your
4 utilization costs are above the blend, you have to pay
5 additional funds above the blend into the pool. And if
6 you're a lower cost utilizer and your total utilization
7 costs are less than the blend, then you pull funds from
8 the pool. And that's how I understand.

9 Q. If I sum up what you're saying, did you
10 understand that if you do Class III manufacturing, you
11 get -- you draw from the pool on an accounting basis
12 maybe, but you draw from the pool?

13 A. Well, probably the better way for me to
14 describe it is your milk costs less.

15 Q. Milk costs less?

16 A. Yeah.

17 JUDGE CLIFTON: And I just want to make
18 sure I heard what you said. You said pull from
19 the pool?

20 THE WITNESS: Yes, ma'am. I did. I'm
21 from Oklahoma. Pull, p-u-l-l, from the pool.

22 JUDGE CLIFTON: Thank you.

23 BY MR. CARROLL:

24 Q. Now, the next sentence you stated: This
25 is an advantage of scale and diversification that is not

1 available to most independent producer-handlers and to
2 us illustrates why producer-handlers cannot, as a
3 factual matter, be responsible for creating any
4 disruption in the national marketplace. Could you
5 explain that sentence?

6 A. Yes. For me, I don't think I'm a
7 disruption. I'm a larger producer-handler. I'm able
8 to -- I'm in the -- I'm in this blend. I'm close to
9 where, you know, I could probably go either way. A
10 smaller producer-handler, I -- I would imagine would not
11 have the same flexibility.

12 Again, perhaps I'm unfairly trying to
13 draw a corollary between myself and maybe a smaller
14 producer-handler that may not have the same ability to
15 balance because a lot of balance is based on scale.

16 Q. Now, the next sentence, you said: I
17 would like to point out that to the extent utilization
18 matches the pool, a producer-handler has no effect
19 whatever on the blend price.

20 Could you explain to me that sentence?

21 A. Yes. The way I understand it is if a
22 handler's utilization is the same as the -- the pool or
23 the blend utilization or the utilization that produces
24 the blend, then the handler's utilization cost or his
25 cost of milk based on the various prices, blend prices,

1 would result in a blend price.

2 Therefore, for a producer-handler, then
3 his producing operations or his milking operation would
4 receive X dollars and he would pay that same X dollars
5 on the handler side, thereby paying himself the exact
6 same money. And it would be p-o-o-l neutral.

7 Q. Braum's is an example of that type of
8 producer-handler, you stated. And I think you have
9 already covered that, I think, that you're at a
10 50 percent point --

11 A. 50 plus.

12 Q. 50 plus. If we were required to
13 participate in the pool, a very likely result could be a
14 decrease in the blend price rather than an increase due
15 to our utilization of Class III milk, precisely the
16 opposite intent of the NMPF and DF -- IDFA proposals.
17 What do you mean by that?

18 A. If I were pooled, and suddenly my milking
19 operation was not being paid what my handling operation
20 was required to pay, in other words, there was a deficit
21 there, then there are things that I currently purchase
22 from AMPI, cheese, that I would probably start making.
23 So I would just increase my Class III utilization and
24 get to or below blend.

25 Q. And what effect, if any, would that have

1 on the blend, according to your statement?

2 A. Well, the higher -- and that's one of the
3 things that's happened in the Central Order, is the
4 Class III utilization has gone up a lot. And so what
5 happens when that happens is the overall blend price
6 comes down. So the more -- the more class utilization
7 that is below the previous blend, then it causes the --
8 the blend price to come down, since all the blend is is
9 it's basically the class price times the utilization
10 percentage, basically.

11 I know you've got all this component
12 pricing stuff. But basically, as I understand it, that
13 gets you back to blend.

14 Q. Does that pricing system have a tendency
15 to induce the use of milk from manufacturing rather than
16 Class I?

17 A. It certainly can.

18 Q. Now, I want to direct your attention to
19 the manufacturing of dairy products. I believe you've
20 said you're engaged in that business. You're familiar
21 with it, I mean, dairy products being put -- dairy fluid
22 products being put into dairy manufactured products?

23 A. I'm not sure I understand.

24 Q. All right. Well, let me withdraw that.
25 At any rate, you know there are manufactured dairy

1 products, and you are engaged in some manufacturing
2 yourself?

3 A. Oh, certainly.

4 Q. In the Class III use, okay? Are we on
5 the same wavelength now?

6 A. Yeah. You're talking about what handlers
7 do. Okay.

8 Q. Is that a profitable business to be
9 engaged in in making ice cream or making butter or
10 making some other dairy product instead of fluid? Can
11 you make money by doing that?

12 A. Can you make money in the handler
13 business?

14 Q. In the manufacturing of business -- of
15 milk into other products?

16 A. I believe so.

17 Q. And on occasion, can that be a greater,
18 more profitable activity than just selling the fluid
19 product itself?

20 A. I'm not sure I understand.

21 Q. Well, let's say you have the alternative
22 in front of you for a moment, hypothetically. You have
23 a hypothetical alternative. You have milk you could put
24 into, let's say, ice cream or into some other similar
25 product that requires some manufacturing.

1 A. Well, but ice cream, I consider that
2 requiring manufacturing, so I guess that's why I'm
3 getting stuck here a little bit.

4 Q. Okay. All right. Can ice cream be a
5 profitable business?

6 A. Yes.

7 Q. And can the same milk perhaps sometimes
8 be more profitable as ice cream than it would have been
9 as fluid milk?

10 A. Oh, sure.

11 Q. And therefore the milk that's involved
12 isn't a waste product, it's put to a productive use?

13 A. Yes.

14 MR. CARROLL: That's all. Thank you.

15 JUDGE CLIFTON: Thank you, Mr. -- excuse
16 me. Thank you, Mr. Carroll. Who next will
17 cross-examine Mr. Bostwick? Mr. Yale.

18 CROSS-EXAMINATION

19 BY MR. YALE:

20 Q. Good morning.

21 A. Good morning.

22 Q. Benjamin F. Yale on behalf of Select Milk
23 Producers and Continental Dairy Products.

24 Mr. Bostwick, you talked about an
25 innovative product or processes to produce this higher

1 solids milk with lower fat. Does the producer-handler
2 model that you have, that is, that you use your own
3 milk, you don't buy it, you use your own milk and bottle
4 it, does that contribute to the innovation and the
5 ability to be innovative in this process?

6 A. I'm sorry. Could I ask you to restate
7 the question?

8 Q. It's probably a terrible question. It's
9 been a long week.

10 A. Okay.

11 Q. Let's take it a different way. That is
12 not a product ordinarily found in stores today, right?
13 That's unique?

14 A. In California it is.

15 Q. Yeah, it is. But that's -- and that
16 process is somewhat -- the amount of other solids is not
17 nearly what you put into yours, though, right?

18 A. Again, all I know is -- is the California
19 standard is higher, and more like what we do is -- how
20 it actually stacks up to what we do, I don't know.

21 Q. Yeah, I don't think it comes close to
22 your 50 percent calcium.

23 A. Okay.

24 Q. And I think your protein is probably
25 protein, 5, 6 percent. Do you know?

1 A. I do not.

2 Q. But it -- but in your market, it's not
3 ordinarily found anywhere else, right?

4 A. Oh, no, it's not ordinarily found.

5 Q. And that was a product that -- that your
6 company decided to -- to do to meet what you believe is
7 a place in the marketplace for a quality dairy product
8 but to make it better and more adaptable to consumer
9 needs, right?

10 A. Yes.

11 Q. All right. And in making that decision,
12 you -- did you have to consider the ramifications of
13 regulatory pricing in whether or not to make that
14 product or how to make that product?

15 A. Certainly considered, but it's a very
16 expensive product for me to make, obviously.

17 Q. Right. But did you look at whether the
18 Federal Order pricing would require you to price some of
19 it as Class I or Class IV in determining whether or not
20 to make the product? Did that factor into your
21 decision?

22 A. I believe it would have, yes.

23 Q. Well, all right, let me take it a
24 different way. You don't pay minimum prices under the
25 Federal Order, right?

1 A. Oh, right, I do not today.

2 Q. Right. Okay. So in designing a new
3 Class I product, you looked at your costs, not the
4 minimum prices, to determine what you could sell that
5 product for. Is that a fair statement?

6 A. That's --

7 Q. You looked at your costs?

8 A. I looked at my costs, yes.

9 Q. You didn't look at what some minimum
10 authority prices under the Order would be?

11 A. No.

12 Q. I think you price your milk kind of
13 independent of what's going on in the Federal Order
14 pricing, is that right? You try to be competitive?

15 A. Yes, I'm a follower. I can't charge any
16 price I want. And I also can't really charge a cheap
17 price because I'd run out of milk. So -- so I have to
18 kind of hang in there with everybody else and try to
19 stay alive.

20 Q. But your relative independence of the
21 Federal Order did allow you to be innovative. Does that
22 contribute to --

23 A. Yeah, I believe so. I believe that's a
24 fair statement.

25 Q. Okay. Now, the -- there was some

1 discussion on transfer costs, intercompany. There's
2 been a lot of talk throughout this hearing that
3 producers -- producer-handlers, I mean, somehow you can
4 break it down and say they got a uniform price as a
5 farmer, and then they have an obligation to pay this for
6 their milk.

7 Well, let me ask you this. Do you -- I
8 think maybe you can't answer this, because I think you
9 testified you have got a controller that decides what
10 these prices are and what the transfer costs are, is
11 that right? He tells you how he is transferring from
12 the farm to the plant?

13 A. Well, I have a chairman that tells me
14 that.

15 Q. A chairman that tells you that. That's
16 even a little more powerful.

17 A. Yeah, it is a little more powerful than a
18 controller.

19 Q. But in the end, it ends up with the same
20 bottom line for your stockholders, right, regardless --

21 A. Exactly. And the tax returns look the
22 same. Everything is the same. It doesn't make any
23 difference. That's why it's a -- I don't get the
24 argument, frankly. It's my costs. That's what it costs
25 me. Anything else is -- to me, is a dishonest way of

1 looking at it.

2 Q. I want to move to another topic just to
3 kind of follow up on some questions on utilization.

4 You talk about your administrative cost.
5 Was there any analysis done that if you had been
6 regulated over a period of a year, two years, three
7 years on a month-to-month basis, what the individual
8 obligation or draws would be into the pool?

9 A. We did a little bit of work on that in
10 2008.

11 Q. And would it be more pay-in than
12 pay-out -- than draw-out? I don't want to use the word
13 pool.

14 A. Yes, I really don't want to get that much
15 into that. It just -- it showed me that I was close, if
16 that helps.

17 Q. Okay. Now, you're aware, are you not,
18 that those utilizations and that obligation is after the
19 month is over with, right? It's kind of a post -- are
20 you -- have any idea at all how that settlement process
21 is done?

22 A. You know, I don't.

23 Q. Okay. Then I'm not going to challenge
24 it.

25 A. Okay. Thank you.

1 Q. You've done so well. I don't want to
2 give you a question that you'll miss so your score goes
3 down.

4 A. Thank you, sir.

5 Q. You were talking about those milkshakes
6 at the stores?

7 A. Yes, sir.

8 Q. You didn't bring any with you?

9 A. No, but if you come to Oklahoma, I'll buy
10 you one.

11 JUDGE CLIFTON: Mr. Beshore.

12 RECROSS-EXAMINATION

13 BY MR. BESHORE:

14 Q. Just one quick follow up to one of
15 Mr. Yale's questions, Mr. Bostwick. I think you said as
16 far as price. You were talking about retail price out
17 of the stores, you know, you're a follower.

18 A. Yes, I believe I am.

19 Q. Okay. In the market. And by that, you
20 mean that the general price levels are set by the --
21 basically, the -- you know, the major marketers of a
22 number of products, which are pool handlers, correct?

23 A. Big dairies, that's right.

24 Q. Big dairies. Okay. And their price goes
25 up -- when the regulated minimum price goes up, their

1 price goes up and when the regulated minimum price goes
2 down, their price goes down, and you follow?

3 A. That's right.

4 JUDGE CLIFTON: Mr. Vetne.

5 RECROSS-EXAMINATION

6 BY MR. VETNE:

7 Q. Okay. I need to follow up on that,
8 Mr. Bostwick. When you referred to the price that you
9 follow, you were referring to the competitive price or
10 the consumer price at the grocery store shelf in other
11 retailers, correct?

12 A. Yes.

13 Q. You were intending to, as Mr. Beshore
14 suggested, follow the price charged by other processors
15 to -- as a wholesale price to those retailers?

16 A. Oh, yeah. I apologize. When I think of
17 price, I think of retail prices. Those other prices
18 don't mean anything to me.

19 Q. You don't follow them. You don't know
20 what they are?

21 A. Well, I started following them in
22 January.

23 Q. How do you follow them? How do you know
24 what other processors are paying -- are charging their
25 wholesale customers?

1 A. I don't know that. What I do know --
2 yeah, I don't know that at all. I know what the class
3 prices have been and what the blends has been, and I
4 certainly know in Kroger's in McKinney, Texas, there's a
5 70 cent difference between their Kroger store brand and
6 their other brand. And I don't understand how they can
7 do that, but -- but they are. And they both are coming
8 out of the same plant. So I don't understand all of
9 that from a pricing standpoint. All I know is, is
10 that's what the consumer knows, and so that's what I'm
11 compared to.

12 Q. Actually, an 80 cent difference.

13 A. Okay. Yes, you're right. And in UPA --
14 oh, I know what it was. I checked the price again
15 yesterday. I called our McKinney store and asked them
16 to go over and check, and they're now selling for 2.69
17 and 1.99. So that's what it is. I'm sorry.

18 MR. VETNE: Okay. Thank you.

19 JUDGE CLIFTON: Just so I have the
20 spelling right when you were talking about that,
21 is McKinney a name of a store or a name of a
22 place?

23 THE WITNESS: It's a city.

24 JUDGE CLIFTON: Oh.

25 THE WITNESS: It's north of Dallas.

1 McKinney, Texas.

2 JUDGE CLIFTON: Okay. Spelled M --

3 THE WITNESS: M-c-K-i-n-n-e-y.

4 JUDGE CLIFTON: Okay.

5 THE WITNESS: Beautiful city.

6 JUDGE CLIFTON: Thanks. And when did
7 Braum's begin to sell the nonfat milk prepared
8 the way it's prepared today?

9 THE WITNESS: We've been doing that quite
10 a while.

11 JUDGE CLIFTON: Decades?

12 THE WITNESS: You know, I don't know.

13 JUDGE CLIFTON: All right. Who else has
14 cross-examination questions? Mr. Tosi.

15 CROSS-EXAMINATION

16 BY MR. TOSI:

17 Q. Good morning, Mr. Bostwick. Thanks for
18 coming so early today.

19 A. Certainly.

20 Q. I'd like to ask, your appearance here
21 today, are you testifying on behalf of just Braum's or
22 is your testimony also -- you know, besides saying that
23 you are supporting the proposals that have been offered
24 by AIDA, are you testifying on behalf of AIDA or just
25 for Braum's?

1 A. I believe I'm just testifying for
2 Braum's, as far as I know.

3 Q. Okay.

4 A. That's really my interest.

5 Q. Okay. I needed to have that clear so
6 that when we go back and we tell the Secretary why you
7 were here, that it's clear that you were here to
8 articulate Braum's' positions.

9 A. Yeah. The other producer-handlers are
10 important to me. I stand along with them and the entire
11 producer handling model, but I don't know how I can
12 testify for them.

13 Q. Okay. Okay. That was what I wanted to
14 ask just to make sure.

15 A. That's a fair question.

16 Q. Okay. In your testimony, you referred to
17 depooling as an example of the blend price being
18 lowered, that it results in the blend price being
19 lowered.

20 A. It actually doesn't always lower it.

21 Q. Okay. Okay. Do you know why depooling
22 occurs?

23 A. My understanding is that depooling occurs
24 when there's an inversion to the status quo. In other
25 words, that generally the Class III price is less than

1 blend, and so a Class III utilizer can purchase that
2 Class III milk -- excuse me -- yeah, Class III milk,
3 that's right, at a lower price. And when that price
4 becomes higher than blend, and in some cases even
5 exceeds Class I price, they don't have to pay that
6 price.

7 And they come out of the pool, which
8 causes the blend to go down, which I -- again, not being
9 familiar with the total mechanics, but my understanding
10 is, is if the blend price goes down, then the farmer
11 gets less in his paycheck because he's paid off the
12 blend.

13 Q. Okay. And with respect to depooling, are
14 you aware that the marketing orders have a set of
15 pooling standards contained in the orders?

16 A. No.

17 Q. Okay. Do you know if an order contains
18 provisions that says, for example, how much milk a
19 producer has to ship to a distributing plant in order to
20 be pooled on the order --

21 A. No.

22 Q. Okay. But you do seem to understand that
23 when milk gets depooled, that there could be a negative
24 impact on the blend price? That part you seem to
25 understand pretty well.

1 A. Yes. Initially I thought that -- that --
2 when I was looking at the -- I think they're called
3 producer receipts. I couldn't figure out why they
4 fluctuated so much from month-to-month, because no one's
5 production could do that, but yet it was called producer
6 receipts. And so I was like, well, what is that?

7 Then I noticed that when I got a
8 utilization split out, I saw that all of the variance
9 was in Class III, but again, not understanding what I
10 was seeing. And then that's when I began to understand
11 this -- this depooling concept that certain utilizers
12 could benefit from legitimately under the rules, and
13 that they certainly appeared to understand that as well.

14 Q. Okay. And do you see depooling as being
15 disorderly then?

16 A. It -- well, again, I don't -- I don't
17 know what disorderly means, but -- but if there's any
18 way possible that I can be disorderly, that's got to
19 really be disorderly.

20 Q. Okay. But you seem to use this as an
21 example of disorder?

22 A. You know, I believe I have, yes.

23 Q. Okay. Okay. And do you know who does
24 the depooling?

25 A. I do not.

1 Q. Would you characterize it, at least in
2 the Central market, that it's cooperatives that largely
3 do that?

4 A. I couldn't do that. I don't know.

5 Q. Okay.

6 A. And again, I apologize, but that's not my
7 specialty area at all.

8 Q. Okay. And following up a little bit on
9 some of the things that Mr. Carroll was asking you, in
10 your statement you talk about diversified cooperatives
11 and processors have this ability to organize their
12 production to avoid payments into the pool. Are you
13 aware that there are co-ops that have the majority of
14 their milk that's Class I that pay regularly into the
15 pool?

16 A. I have no idea.

17 Q. Okay. When you came up with your
18 estimate on the cost burden of \$300,000 --

19 A. Yes.

20 Q. -- and you characterize it as simply for
21 the oversight to ensure that you are paying yourself for
22 the right amount for your own milk?

23 A. Yes.

24 Q. That's an impressive number. How -- how
25 was it that you came up with \$300,000?

1 A. Well, the number wasn't exactly 300, but
2 it was -- it was close to 300. So it was in that 300
3 range. And we actually got that from the Central Order.
4 They gave me that number.

5 Q. That was their estimate that they gave to
6 you --

7 A. Yes.

8 Q. -- when you asked them to figure it out
9 then?

10 A. Yes.

11 MR. TOSI: Okay. Mr. Bostwick, that's
12 all I have. I appreciate your patience.

13 THE WITNESS: Thank you, sir.

14 MR. TOSI: And I appreciate you coming
15 all this way to testify at this proceeding.

16 THE WITNESS: I hope it helped.

17 MR. TOSI: Thank you.

18 JUDGE CLIFTON: Mr. Ricciardi, any
19 redirect?

20 MR. RICCIARDI: Thank you, your Honor.

21 REDIRECT EXAMINATION

22 BY MR. RICCIARDI:

23 Q. Mr. Bostwick, I have some areas of follow
24 up with you, and some, hopefully, clarifications based
25 upon a lot of testimony that's been given.

1 In response to a number of questions, you
2 said, as a lead in, well, I first learned or I learned
3 about that in January. Do you remember those kind of
4 responses?

5 A. Yes.

6 Q. Okay. Let me see if I can pinpoint what
7 you're really talking about. You're talking about
8 January of this year?

9 A. Yes.

10 Q. Okay. And the time period that piqued
11 your interest is when Braum's became aware of the
12 proposals that had been made by National Milk and IDFA
13 to eliminate the producer-handler exemption?

14 A. Yes.

15 Q. Okay. So that's when you started to pay
16 attention to all of this Federal Milk Marketing stuff,
17 right?

18 A. Yes.

19 Q. Okay. And that -- and that was the end
20 of January, beginning of February was the first time
21 that Braum's was aware of this, right?

22 A. Yes.

23 Q. A question was also asked of you about
24 essentially what happens if, I guess, the elimination
25 proposals actually get adopted in some fashion by the

1 Department. Do you know at that point, because we don't
2 know, in fact, what proposals will be adopted, how
3 Braum's would have to adapt to those changing
4 regulations?

5 A. Well, I'm paid to think a lot about
6 things like that, and I have been thinking a lot about
7 that. I believe that Braum's, because we -- we already
8 have a good healthy mix of utilizations, I don't think
9 there should be any change to this. It's been around
10 for a long time, 70 years or whatever it is. But if it
11 did happen, Braum's is resilient, creative and will have
12 to deal with it.

13 Q. You hope to be able to survive in some
14 fashion or another to the change, right?

15 A. Yes, I do.

16 Q. Okay. And it may require, potentially,
17 restructuring the operation?

18 A. Sure. It -- it could. Again, you know,
19 \$300,000 at a 7 percent cap rate is a \$4.2 million
20 number, and so that's what I could go out and do cap X
21 for. So it's not a nothing number.

22 Q. Okay. And the \$300,000 is an admin
23 service fee, it does not take into consideration what
24 the pool impact for a pool payment would be if the
25 producer-handler exemption were eliminated, right?

1 A. Right, right. And there's no way for me
2 to know what that could possibly be because it moves.

3 Q. Is one of the decisions back in '01 that
4 made Braum's decide to become a producer-handler Federal
5 Order reform?

6 A. Yes.

7 Q. And the financial costs imposed by
8 Federal Order reform on Braum's?

9 A. Well, yes, the utilization percentage of
10 the blend -- for the -- yeah, the Class I utilization
11 was decreasing in the order after the order reform.
12 And -- and what it essentially did, even though my
13 operation on either side, the producer or the handler
14 side, didn't change a bit, but because of the
15 characterization or the change in the characterization
16 of the pool, suddenly my cost and my reimbursement
17 changed dramatically. And it's like, well, I don't -- I
18 don't understand that. And so it was something that we
19 decided that we should no longer be pooled.

20 Q. I understand. I want to clarify one more
21 point, I think, so that it is clear in this record. In
22 terms of looking at pricing for fluid milk products,
23 certainly at least before January, February of this
24 year, you weren't looking at what the Class I price was,
25 the blend price or anything like that in terms of what

1 you were doing with your retail operation, were you?

2 A. No.

3 Q. You were just trying to look around and
4 see what the consumer prices in general were in your
5 area?

6 A. Specifically within a three-mile radius
7 of each one of my stores.

8 MR. RICCIARDI: That's right. I don't
9 have any further questions.

10 JUDGE CLIFTON: Thank you, Mr. Ricciardi.
11 Mr. Bostwick, this is an excellent statement,
12 and I thank you for testifying.

13 THE WITNESS: Thank you for your help.

14 JUDGE CLIFTON: Do initial the changes
15 before you leave.

16 THE WITNESS: Thank you.

17 JUDGE CLIFTON: Let's take a 20-minute
18 break. It's five minutes to 10:00. Please be
19 back and ready to go at 10:15.

20 (A recess was taken from 9:55 to 10:19.)

21 JUDGE CLIFTON: We're back on record at
22 10:19. I have marked the statement of Sally
23 Keefe as Exhibit 88. Ms. Keefe, would you
24 please state and spell your name.

25 (Exhibit 88 was marked for

1 identification.)

2 THE WITNESS: My name is Sally Keefe,
3 S-a-l-l-y, K-e-e-f-e.

4 JUDGE CLIFTON: Thank you. If you'll
5 raise your right hand, I'll swear you in.

6 (The witness was sworn.)

7 JUDGE CLIFTON: Thank you.

8 Mr. Ricciardi.

9 MR. RICCIARDI: Good morning, your Honor.

10 SALLY KEEFE

11 of lawful age, being duly sworn, was examined and
12 testified as follows:

13 DIRECT EXAMINATION

14 BY MR. RICCIARDI:

15 Q. And good morning, Ms. Keefe. How are
16 you?

17 A. Good morning. I'm fine.

18 Q. Okay. Can you tell us, please, your
19 responsibilities at Aurora Organic Dairy?

20 A. I'm responsible for the company's
21 regulatory affairs. That includes dealing with dairy
22 regulatory issues as well as organic certification,
23 things like that.

24 JUDGE CLIFTON: Your voice is soft.

25 THE WITNESS: Okay.

1 JUDGE CLIFTON: So a little closer to the
2 mic, please.

3 Q. And in that capacity, have you been
4 authorized to prepare a response to proposals that have
5 been made by National Milk and IDFA, 1, 2 and 26, as
6 well as support for Proposals 23, 24, and 25 at this
7 hearing by Aurora Organic Dairy?

8 A. Yes.

9 Q. And have you prepared a statement that
10 you intend to present at the time of this hearing?

11 A. Yes.

12 Q. That statement has now been marked for
13 identification as Exhibit 88 and you have it in front of
14 you?

15 A. I do.

16 Q. Would you proceed with the statement,
17 please?

18 A. My name is Sally Keefe. I'm a vice
19 president at Aurora Organic Dairy. I have been with the
20 company since it began in 2003. My responsibilities
21 include dealing with regulatory issues affecting the
22 company. I have a bachelor's degree in economics from
23 Middlebury College and an M.B.A. from the University of
24 Colorado. Prior to working at Aurora, I was responsible
25 for milk procurement at another organic dairy. I'm

1 familiar with the FMMOs and their impact on the organic
2 milk market.

3 Aurora Organic Dairy is a leading
4 supplier of private-label and store-brand organic milk
5 and butter to U.S. retailers. Our mission is making
6 high-quality organic milk and butter more affordable and
7 available for mainstream Americans.

8 We have 345 employees. We milk about
9 12,000 cows every day at our five farms in Colorado and
10 Texas. Aurora is organized as a corporation in which a
11 number of employees have an equity stake. Aurora
12 Organic Dairy is a producer-handler. All of the milk
13 that we process in our plant in Platteville, Colorado,
14 is produced on our farms.

15 Our goal when we started was to develop
16 the market for private-label organic milk. We had
17 identified this market segment as being underserved. To
18 do this, we needed both reliable organic milk supply and
19 processing. Most organic milk was and still is
20 processed under co-packing arrangements. This creates a
21 situation where organic competes for line time,
22 attention, et cetera, with everything else that the
23 co-packer is making. So we decided to build a dedicated
24 processing plant for our own milk. In 2004 we opened
25 our state-of-the-art processing plant. Our total

1 investment in the plant was over 35 million.

2 One critical responsibility a
3 producer-handler necessarily undertakes is balancing its
4 own milk supply. Balancing is a burden the
5 producer-handler takes on in exchange for the benefits
6 of operating independently. We balance our milk by
7 careful management of, one, our finished goods
8 inventory; two, production of powder and butter at
9 co-packers; three, bulk sales; and four, farm
10 production. We use our finished goods inventory to even
11 out the peaks and valleys of our orders relative to our
12 farm production. Powder and butter are medium and
13 long-term balancers as their shelf lives are
14 substantially longer than that of fluid milk. Sales of
15 bulk milk outside of our business are made as either
16 organic or conventional, but there is no way to
17 anticipate whether there will be organic outlet for any
18 extra production we might have at any given point in
19 time. To balance ourselves over the long term we very
20 carefully manage our production at the farms.

21 Milk balancing is what we have to do when
22 the supply and demand for our milk do not line up.
23 Suggesting that we are somehow incapable of balancing
24 our own supply because of our status as a
25 producer-handler is nonsensical. It is always the case

1 that our customers have alternative suppliers, as well
2 as product options and a variety of size formats. Such
3 choices include beverages other than fluid milk; for
4 example, fortified juice and soy drinks.

5 If anything, the fact that we can only
6 look to ourselves for the milk that we need to fill our
7 orders puts increased balancing pressure on us. Because
8 Aurora is not a qualified pool producer, it does not
9 share in the pool value. So if we overproduce and need
10 to sell our milk into the conventional market to a
11 cheesemaker, for example, we only obtain the Class III
12 price for that milk, not the blend. Although the blend
13 price would not offset the significantly higher cost of
14 production of organic milk, it is still additional
15 compensation to which we do not have access.

16 We do not produce anything other than
17 certified organic milk. As a result, our cost of
18 production is considerably higher relative to
19 conventional producers. Because only milk that has been
20 produced and certified in accordance with the
21 requirements of the Organic Foods Production Act and the
22 National Organic Program regulations is entitled to be
23 called organic and labeled with the USDA organic seal,
24 our milk is simply not interchangeable with conventional
25 milk. We cannot purchase conventional milk from pool

1 producers and sell it as organic. We can only use
2 certified organic milk.

3 The proponents of Proposals 1, 2 and 26
4 have suggested that a producer-handler acquires milk at
5 the blend. This is simply not true. A producer-handler
6 acquires milk at the cost of production on the farm.
7 The cost of production for organic milk always exceeds
8 FMMO class and uniform prices. Our cost of production
9 is about \$30 per hundredweight. This is at the farmgate
10 and includes the capital and operating expenses of the
11 farms, for example, feed, cattle, labor, and debt
12 service. This figure, however, does not include
13 transportation from our farms to our processing plant,
14 nor does it include any -- the capital or operating
15 costs associated with our processing plant. Nor would
16 it include any distribution costs.

17 We are not similarly situated to others
18 in the organic marketplace because we have invested in
19 both organic dairy farming and processing and bear the
20 full risk and responsibilities of both. Dairy farming
21 is a biological process and inherently uncertain. It is
22 risky for a number of reasons, including (among other
23 things) the uncertainty of calving schedules, the threat
24 of disease, ever-changing commodity costs and the
25 impacts of weather. Likewise, processing has its

1 attendant risks, among which include equipment and
2 packaging failures and variability of customers' orders,
3 not to mention the large investment required up front to
4 build the plant in the first place. A producer-handler
5 incurs all of this risk and must also develop and
6 sustain markets for its products.

7 I am aware that NMPF and IDFA assert that
8 producer-handlers win business from the regulated pool
9 on the basis of the theoretical price advantage. This,
10 however, is not true. As someone who has been dragged
11 on sales calls, I am here to tell you that in the
12 absence of service and quality, price is irrelevant.
13 Moreover, producer-handlers do not actually have a price
14 advantage.

15 Retailers select private label suppliers
16 who have the ability to provide the needed product and
17 volume, prioritize the customer's business to meet all
18 expectations and challenges and deliver reliable
19 fulfillment of product orders. Customers want private
20 label suppliers who show rigorous quality assurance
21 capabilities, are in control of their supply chain and
22 can implement corrective action effectively and quickly.

23 The benefits of being vertically
24 integrated include providing traceability and complete
25 control of our organic milk. The fact that we process

1 all of our organic milk ourselves is very important to
2 our customers, because as a result, our customers know
3 the source of all of the milk and also know that it was
4 processed in a plant that is dedicated to organic. A
5 lot of processing plants do both organic and
6 conventional milk, for example, on alternative shifts,
7 and it gives our customers a great deal of comfort
8 knowing that their milk could not have possibly been
9 commingled with conventional milk.

10 The importance of good service and
11 quality in a competitive environment can be illustrated
12 by several examples:

13 One regional customer launched its
14 organic milk brand with another vendor who could not
15 fulfill its orders completely. The customer pulled the
16 products because of high out-of-stock conditions risked
17 potential damage to its store brand image with
18 customers. Over a year later, we were hired to relaunch
19 the products, and the business succeeds today.

20 A national account customer hired us for
21 a secondary supply role after being initially supplied
22 by a national brand vendor. Our service levels
23 continuously exceeded those of the national brand.
24 This, in turn, made it clear to the customer that the
25 branded supplier simply did not value the customer's

1 business the way we did. We were awarded additional
2 roles with the customer, even at higher prices than the
3 other vendor, until all the business was awarded to us.

4 One customer launched its private organic
5 milk with another vendor and discontinued the products
6 after suffering spoilage problems. After being
7 reassured by our product quality and reliability, the
8 customer relaunched the products and has been
9 successful.

10 Based on our experience, we have not
11 observed the producer-handlers have any price advantage
12 resulting in a competitive advantage in the marketplace.
13 We have lost customers to other organic milk suppliers
14 who are able to provide what the customer perceived to
15 be a better value. These suppliers are not
16 producer-handlers. In addition, it is also worth noting
17 that most of our customers carry other organic milk in
18 addition to that which we supply. This means that our
19 customers give shelf space to the products of other
20 organic suppliers, and it is therefore absolutely the
21 case that many of our customers also buy from our
22 competitors even while buying milk from us.

23 The effects on Aurora if Proposals 1, 2
24 or 26 are adopted by USDA would be dramatic and
25 potentially devastating. It is overly simplistic to

1 conclude that because Aurora Organic Dairy is a
2 producer-handler that we have a price advantage, much
3 less a price advantage that would create any disruption
4 in the market. Unlike organic producers who do not
5 process their own milk, we have invested millions of
6 dollars in a dedicated processing plant. And unlike
7 handlers who do not produce organic milk, we have
8 invested millions of dollars into our farming
9 operations. We have also incurred the attendant risk of
10 balancing ourselves, which as previously indicated is no
11 small risk given that we have to find our own markets
12 and outlets for our supply.

13 With respect to the pool itself, is there
14 a stable and certain supply of organic milk for us to
15 call upon? No. Is there a balancer willing to dry and
16 sell organic powder in our milk shed? No. For us in
17 the organic market, the pool does not facilitate the
18 balancing function due to the fragmented and dispersed
19 nature of the organic milk supply and plants. If the
20 proposal to eliminate producer-handlers is adopted,
21 Aurora would have to restructure and essentially
22 completely revise our business model.

23 We support the existing regulatory
24 provisions and we do not want to see any changes. In
25 our view, it is not possible to determine the presence

1 or absence of orderly marketing conditions without
2 considering the actual prices being paid to producers
3 and the actual costs incurred by handlers for the milk
4 they buy. Based on the actual prices and costs in our
5 market, we do not observe any unfair competition or the
6 creation of any disruption in the marketplace as a
7 result of producer-handlers.

8 In light of this, we believe the status
9 quo is the best available course. If Proposal 23 or
10 Proposal 25 were adopted, Aurora could continue to
11 operate as a vertically-integrated business, although
12 some modifications might be necessary. AIDA has
13 proposed an own-farm milk exemption, which we understand
14 to mean that anything purchased from outside our own
15 farm operations would be valued at Class I price to the
16 pool.

17 Aurora also supports individual handler
18 pools. As other organic producers have testified at
19 these proceedings, organic producers and processors
20 obtain very limited benefits from pooling. This is also
21 true of other differentiated milk markets, such as grass
22 fed and kosher. Individual handler pools would result
23 in differentiated producers and processors being on
24 equal footing with respect to the pools.

25 Aurora believes any national policy that

1 is adopted should preserve options, not foreclose them.
2 Some of the proposals frankly punish vertical
3 integration in any form other than a cooperative. This
4 is quintessentially anticompetitive and bad for
5 consumers because it freezes the U.S. marketplace, it
6 picks one business model as the winner, it stifles the
7 entrepreneurial enterprise, and it eliminates
8 independent vertically-integrated operations that meet
9 changing consumer demand.

10 Thank you for the opportunity to testify
11 today. I am prepared to answer any questions regarding
12 my statement.

13 JUDGE CLIFTON: Thank you, Ms. Keefe.

14 Mr. Ricciardi.

15 BY MR. RICCIARDI:

16 Q. Before we get to that, there are a couple
17 of points on your statement where you added some
18 language, and I wanted to confirm with you that you
19 intended to do that, and ask you whether we should
20 change the statement accordingly, at least from my
21 notes.

22 The first one is on page 4 under the
23 heading, How We Compete, the second sentence -- third
24 sentence, I apologize. You added the word, after been
25 and before on, the word dragged: As someone who has

1 been dragged on sales calls. Did you intend to do that?

2 A. That was probably a Freudian slip.

3 Q. Would you like your statement to be
4 amended or supplemented to include that language?

5 A. Not that particular word, thank you.

6 Q. Okay. I can understand the issue.

7 Bottom of page 5, which would be the
8 third sentence, near the end of that sentence, after
9 customers and before business, you added the language
10 private label. So it would read: Did not value the
11 customer's private label business the way we did.

12 Did you intend to amend your statement to
13 include that language?

14 A. Yes.

15 Q. Okay.

16 JUDGE CLIFTON: Now, let me make sure.
17 I'm looking at page 5 and I go up to the third
18 line from the bottom. And read me, Ms. Keefe,
19 how it will read.

20 THE WITNESS: The third line from the
21 bottom would read: Customer's private label
22 business the way we did. We were awarded
23 additional roles.

24 MR. RICCIARDI: Okay. So the full
25 sentence would read then, your Honor: This, in

1 turn, made it clear to the customer that the
2 branded supplier simply did not value the
3 customer's private label business the way we
4 did.

5 JUDGE CLIFTON: Thank you. I would ask
6 Kate Fisher to make that amendment for the
7 witness' initialing.

8 BY MR. RICCIARDI:

9 Q. Okay. And the last change that I noted
10 between your statement and your reading of it would be
11 on page 7 under the heading, Conclusion. The last
12 sentence in the first full paragraph beginning with the
13 word, based, based on the actual prices.

14 When you read the statement, instead of
15 the word market, you added the word, place, so it read
16 marketplace. Did you intend to make that change for
17 your statement so that the -- let me read the entire
18 sentence the way you read it: Based on the actual
19 prices and costs in our market, we do not observe any
20 unfair competition or the creation of any disruption in
21 the marketplace as a result of producer-handlers.

22 Is that a change that you would like to
23 make or an amendment to the statement or would you like
24 the statement to stand as is?

25 A. I misspoke. It should -- the word should

1 have been market.

2 MR. RICCIARDI: Okay. Those are the only
3 ones that I had.

4 JUDGE CLIFTON: Thank you. I was
5 watching, Mr. Ricciardi, and I didn't see any
6 material alteration. So the only change we'll
7 make, then, is the one on page 5.

8 MR. RICCIARDI: Okay. And I have a
9 clarifying point before I would move then, the
10 admission of the exhibit and the statement.

11 BY MR. RICCIARDI:

12 Q. Ms. Keefe, on the bottom of page 5,
13 actually where we made the change, you are discussing a
14 national account customer that was being supplied by a
15 national brand vendor. And you state in the last
16 sentence: We were awarded additional roles with the
17 customer even at the higher price -- prices than the
18 other vendor until all the business was awarded to us.

19 Focusing your attention on that, was the
20 national brand vendor a producer-handler or not a
21 producer-handler?

22 A. The national brand vendor was not a
23 producer-handler.

24 Q. So that Aurora was selling in that case
25 at a price that was actually higher than the

1 nonproducer-handler vendor, is that your testimony?

2 A. Yes.

3 Q. Okay.

4 MR. RICCIARDI: With that clarification,
5 your Honor, we would at this point move the
6 admission of Ms. Keefe's statement, Exhibit 88
7 as amended in that one spot into the record.

8 JUDGE CLIFTON: Thank you. Is there any
9 objection? There is no objection. Exhibit 88
10 is hereby admitted into evidence.

11 MR. RICCIARDI: And I will stand down and
12 await redirect. Thank you.

13 JUDGE CLIFTON: Mr. Vetne, you may begin
14 cross-examination of Ms. Keefe.

15 CROSS-EXAMINATION

16 BY MR. VETNE:

17 Q. Good morning, Ms. Keefe.

18 A. Good morning.

19 Q. Thank you for coming. My name is John
20 Vetne. I'm from New Hampshire. I represent two
21 producer-handlers in the Pacific Northwest and one in
22 Roswell, New Mexico.

23 Let me ask you first, have you ever done
24 anything like this before?

25 A. No.

1 Q. Okay. You have no prior witness
2 experience in a Federal Order proceeding?

3 A. Definitely not.

4 Q. I'd like you to take your time, listen to
5 my question, preferably pause a little bit before you
6 answer my question. Don't let me drag you into a quick
7 exchange in which you might anticipate my answer. All
8 right?

9 A. Okay.

10 Q. You indicate some familiarity with
11 FMMOs -- that's Federal Milk Marketing Orders,
12 correct --

13 A. Yes.

14 Q. -- and their impact in the organic milk
15 market. When did your familiarity with Federal Milk
16 Marketing Orders start?

17 A. I first learned what a Federal Milk
18 Marketing Order was in 1996, and my knowledge has
19 expanded since then but compared to someone that would
20 have had a conventional role at a conventional dairy
21 perhaps more slowly because organic has some different
22 challenges.

23 Q. Okay. In 1996, what were you doing that
24 caused you to start becoming familiar with Federal Milk
25 Marketing Orders?

1 A. I worked in an operations department of
2 another organic dairy company, and we were -- at the
3 time the company did not understand the charges that
4 were coming through from the co-packer regarding
5 pooling. And I was asked to try to figure it out.

6 Q. And who was your employer at that time?

7 A. My employer at that time was Horizon
8 Organic Dairy.

9 Q. Aurora Organic makes from its own-farm
10 milk, fluid milk products, butter and nonfat dry milk?

11 A. That's correct.

12 Q. Does Aurora Organic make any other dairy
13 products?

14 A. No, the only other dairy products that we
15 market are bulk milk, items certified organic or
16 occasionally conventional.

17 Q. Aurora Organic packages no cream or half
18 and half?

19 A. We do not currently package any cream or
20 half and half.

21 Q. You said you milk about 12,000 cows every
22 day at our five farms. I'm assuming that 12,000 cows is
23 the aggregate of the five farms, not an individual?

24 A. Yes, that's correct.

25 Q. And that is the milking portion of your

1 herds?

2 A. Yes. That's our average cows in milk or
3 cows in tank number. Our total herd size would be about
4 15,000 when you include the dries.

5 Q. And what is the per -- average per cow
6 production in the milking herd?

7 A. That's competitively sensitive
8 information that I'm not really comfortable discussing
9 here.

10 Q. All right. There is data on average
11 production per cow by state, by region and various
12 official sources. Is your per cow production
13 significantly different from the publicly reported data?

14 A. Generally within organic, and this is
15 true for us as well, our per cow production is lower
16 than what is seen reported in aggregate.

17 Q. Okay. And from your total production,
18 you produce some Class I products and some Class IV
19 products. Can you tell me what the range of
20 utilization in Class I of your total production is
21 during the course of the year or during the course of
22 several years?

23 A. We're in the fluid milk processing
24 business. Our Class I utilization is very high. It
25 would generally be close to 90 percent of our total milk

1 supply.

2 Q. That would be an average over the course
3 of months?

4 A. Uh-huh. It would be an average over the
5 course of years.

6 Q. Over the course of years. So on a
7 month-to-month basis it would be less than 90 and some
8 months more than 90, is that correct?

9 A. That's correct.

10 Q. By the way, when you make butter, is that
11 sold in bulk, too, or do you package and label and sell?

12 A. The vast majority of the butter that we
13 sell is private label or store brand organic butter. We
14 do do some bulk, what we think of as ingredient sales of
15 organic butter, but that is more limited.

16 Q. And the powder, is that packaged in
17 consumer packages and sold to stores?

18 A. No, the powder is packaged as a -- the
19 powder is packaged in 50 pound bags. It's an
20 ingredient. It's not very consumer friendly.

21 Q. It's sold to manufacturers that use it as
22 an ingredient in other organic -- in other products that
23 they can advertise as organic?

24 A. Yes, that's correct. Our -- our
25 certified organic nonfat dry milk powder is a

1 100 percent organic ingredient. The organic regulations
2 are very specific regarding whether the -- the labeling
3 claims that you can make with respect to organic are
4 very specific regarding the ingredients in your product.
5 So our powder is a 100 percent organic ingredient.

6 Q. Okay. On page 2, you are discussing the
7 burdens of balancing. And under those various types of
8 balancing activities, one is bulk sales. And I infer
9 that to be sales of -- a bulk sale of raw milk, is that
10 correct?

11 A. That's correct. We do occasionally sell
12 bulk loads of standardized heat-treated milk, if there's
13 a specific demand for it.

14 Q. Do you ever sell cream in bulk?

15 A. We do occasionally sell cream in bulk,
16 but that is very -- our -- we balance our fat
17 utilization with the butter.

18 Q. And you never purchase either bulk milk
19 or bulk cream from any outside source?

20 A. As a producer-handler, we can purchase up
21 to 150,000 pounds of bulk milk per month. And we have
22 occasionally purchased up to but not more than
23 150,000 pounds of certified organic bulk milk.

24 Q. One of the balancing activities in which
25 you engage, you identify as farm production; we balance

1 our milk by farm production. So describe the farm
2 production part of that activity.

3 A. Those are our worst balancing choices.
4 They have -- when -- we frequently make management
5 decisions on our farm that would seem nonsensical to
6 other dairy producers.

7 Our breeding and calving schedules will
8 be -- we look at that very carefully as far as when
9 we're having cows come into milk, when we're drying cows
10 off. We also -- our culling criteria will change
11 depending on our market conditions and, because of the
12 biological nature of dairy farming, when we make those
13 types of decisions that can have very long-term impacts
14 on our herd productivity.

15 So if we are long milk and early dry a
16 group of cows, that can, for example, cause their next
17 lactation to be a lower productivity than it otherwise
18 might have been.

19 Q. Okay. I think we need to explain a
20 little bit. Long on milk and early dry.

21 A. So --

22 Q. Let me tell you what my understanding is.
23 A milking cow has a finite milking cycle, a period where
24 you stop milking the cow and impregnant the cow, produce
25 a calf and get another milking cycle. Am I correct?

1 A. Yes, hopefully she's pregnant before you
2 dry her off.

3 Q. And early dry means toward the end of the
4 milking cycle, you can take a cow out of production
5 earlier than you normally would?

6 A. Uh-huh.

7 Q. Is that correct?

8 A. Yes.

9 Q. Towards the end of a milking cycle, a
10 cow's production tends to decline a bit, doesn't it?

11 A. Yes, it does.

12 Q. So you take it out earlier in that cycle
13 when it's declining anyway and you have less milk that
14 you need to handle?

15 A. That would be correct.

16 Q. And you might also keep a cow in
17 production longer than its ordinary milking cycle even
18 though the production is declining if you are short of
19 milk?

20 A. Yes. If we were short of milk, the
21 inverse would be that we might not cull an open cow at,
22 you know, 305, 400 days of milk, something like that,
23 that we would continue milking her if we were short, and
24 then that culling decision would be pushed into the
25 future.

1 Q. And because of the declining production
2 at the end of the milking cycle, that volume costs a bit
3 more to produce?

4 A. Yes, indeed.

5 Q. Do organic farms have special feed that
6 they need to feed their herd that costs more than
7 conventional farms?

8 A. Yes. As I noted in my statement, our
9 cost of production is about \$30 per hundredweight.

10 Q. That's what I was referring to. I was
11 trying to get to that.

12 A. Most of -- a lot of that difference has
13 to do with the cost of feed, although since what I gave
14 was a per hundredweight cost, some of it you would also
15 have to consider the productivity of our herd when you
16 think about the economics of the farm.

17 Q. On the feed side, you purchase rations,
18 protein rations for your cows?

19 A. Organic cows need to eat just like other
20 cows. And so within the organic production system the
21 ration must include pasture. Cows must be grazed during
22 the grazing season, so our rations include both pasture
23 as well as what's known in the industry as a TMR or
24 total mixed ration.

25 We -- we -- we grow our own pastures to

1 provide feed for our cows. That doesn't come out quite
2 right when I say it, but I think you can get the idea.
3 We do not grow our own forages and concentrates. We
4 purchase organic grain, and we purchase organic hay and
5 we purchase organic silage, et cetera. But the
6 pastures are inherently ours.

7 Q. Do you harvest and store the product of
8 your pastures to feed your cows?

9 A. No, we don't. We generally do not cut
10 hay from our pastures. We graze them. We use
11 intention -- we use intensive rotational grazing during
12 the growing season in order for -- as a forage source
13 for our cows.

14 Q. All right. Is one way that you affect
15 the per cow production to meet your fluid needs is to
16 change a little bit of the amount of ration to pasture
17 or ration to hay, that kind of thing?

18 A. Yes, certainly. You can look at the
19 cow's total ration as far as the milk production that
20 you are going to be getting. But again, that's a very
21 careful balance, you know, much like the culling and
22 drying that I discussed previously.

23 When -- when you change the ration, you
24 have to be very cautious that you don't introduce
25 long-term problems into the herd that could -- that

1 could damage the productivity of your cow in the
2 future -- the herd in the future.

3 Q. Okay. On page 3 you talk about
4 overproduction and selling additional milk into the
5 market to a cheesemaker. You say you only obtain the
6 Class III price. I find that very interesting. Do you
7 get the Class III price when you offer it?

8 A. As you might imagine, if the milk cost us
9 \$30 to produce, the amount of conventional milk that I
10 have sold is pretty limited. When we get to the point
11 that we're considering that, we've already lost
12 generally far more than half the value. We have
13 sometimes sold conventional milk at points in time where
14 you got Class III plus a little bit.

15 We've occasionally -- but in my
16 experience, it typically goes the other way. You know,
17 since I'm -- since I'm not a routine vendor -- and I
18 understand this -- I'm not there to supply them all the
19 time, so I get a spot price. And it's Class III minus
20 this and minus that, and do I really want it and all the
21 rest.

22 Q. Exactly right. Your milk, when you do
23 that, is, at least for you, distressed milk?

24 A. It is extraordinarily distressed milk and
25 if we do very much of it, we won't be in business for

1 very long at all.

2 Q. And you're a price taker, whatever
3 they're willing to pay, basically?

4 A. Whatever they're willing to pay, and
5 we -- sometimes what the conventional market is
6 offering, frankly, it doesn't even make sense to sell
7 it.

8 Q. At the bottom of that same page, page 3,
9 you include in your cost of production something under
10 the heading of debt service. That would be the amount
11 that you're paying to your lenders for principal and
12 interest or what?

13 A. Like most businesses, we have capital
14 costs. We do not -- we do not own our farms outright.
15 We have mortgages on them. We're paying them off. We
16 also have -- we also have loans, you know, to cover our
17 working capital costs and the rest of it. And we look
18 at it and allocate it between -- try to get a sense of
19 what it would be if it were just the farm.

20 Q. My question relates to this. There are
21 many ways to -- there are different ways to calculate
22 cost of production, particularly with respect to the
23 noncash costs.

24 A. Uh-huh.

25 Q. And there are also different ways on the

1 cost of production calculation to account for -- for
2 debt and payments on debt.

3 A. Yeah.

4 Q. The -- the principal part of -- a
5 principal interest payment to a lender ordinarily is not
6 included in cash costs -- I'll represent that to you --
7 but instead comes under a different heading called
8 depreciation.

9 A. Uh-huh.

10 Q. The interest costs are an expense, but
11 the cost of the asset is reflected in depreciation.
12 With respect to that scenario, how -- where is de --
13 depreciation, if at all, here?

14 A. Depreciation of the cattle as well as the
15 farms would be in here.

16 Q. It would be in the debt service or
17 someplace else?

18 A. It would be in the -- well, it's -- the
19 debt service would be the interest.

20 Q. The interest?

21 A. But the -- but the -- but the \$30 does
22 include the depreciation of the cattle as well as the
23 farms.

24 Q. Cattle, farms, equipment, everything
25 else?

1 A. The tractors, the loaders, the -- yes.

2 Q. You talk about this not including
3 transportation costs, which is ordinarily part of the
4 farmer's cost of production. How far are your farms
5 from your processing plant?

6 A. The distance varies. Our -- one of our
7 farms is located adjacent to our processing plant, so a
8 quarter of a mile. The most distant farm is located
9 about 600 miles.

10 Q. All right. And now turning to page 5,
11 your bullet, the first bullet paragraph, you refer to a
12 regional customer. What kind of customer was that?

13 A. We -- we work with grocery retailers
14 across the country. Some of those grocers are national
15 chains and some of those grocers are regional changes.
16 And so in this example it's a regional chain.

17 Q. It's a grocery customer?

18 A. Yes, all of our customers are grocery
19 customers in the macro sense of the word.

20 Q. You do not sell to distributors who in
21 turn sell to customers?

22 A. In a few cases, the grocers will have a
23 distributor between -- between us and the store, but
24 that's always the customer's choice.

25 Q. The customer meaning the grocer?

1 A. Meaning the grocer, yes.

2 Q. You make a deal with the grocer, and
3 sometimes make different deals on how it gets to the
4 grocer?

5 A. Yeah, some of the grocers have their own
6 warehouses, some of them don't. They have all different
7 distribution networks on their end, so you need to fit
8 in with what they're doing.

9 Q. With respect to that regional customer --
10 well, let me ask you this. Can you identify that
11 regional customer? Are you willing to?

12 A. No, I'm not willing to identify any of
13 the customers by name. Ones that we have deserve the
14 confidentiality and the ones that we have lost, I hope
15 to win it back someday.

16 Q. You are aware that when you process milk
17 and somebody goes to the stores that sell milk that you
18 process, anybody in the world can look at the plant code
19 and see that it's Aurora milk coming in to that
20 customer?

21 A. Yes, I know that.

22 Q. You just don't want to make it easy?

23 A. I don't want to make it particularly
24 easy. And our customers asked me that I don't, so --

25 Q. Okay. That's fine. And at the end of

1 that first bullet, you say: And the business succeeds
2 today.

3 My assumption is you were not referring
4 to the success of the customer but success of the
5 product line that you offered?

6 A. Yes.

7 Q. Okay. And in the second bullet, you
8 refer to a national brand vendor. Are you willing to
9 disclose the identity of the national brand vendor,
10 without revealing who the customer is that you both try
11 to supply?

12 A. No. It's a -- I mean, organic is very
13 competitive, and it's also a relatively small part of
14 the dairy industry. And I -- I don't want to malign my
15 competitors.

16 Q. Let's try it this way. How many national
17 brand vendors of organic milk are there?

18 A. There are three.

19 Q. Can you identify the three so that at
20 least we have the universe in which you refer?

21 A. I'll identify the universe for you. The
22 universe includes Horizon Organic Dairy, my former
23 employer; Organic Valley, and HP Hood.

24 Q. And you?

25 A. No. I would be the fourth. There are

1 three national brands.

2 Q. Okay. National brands having their own
3 brand label?

4 A. Yeah, they --

5 Q. Got it. The first bullet on the top of
6 page 6 again, when you're referring to, in the last
7 clause there, to successful, you're referring to the
8 success of the product line, not the success of the
9 company business?

10 A. Yes, sir.

11 Q. In the next paragraph you say: It's
12 worth noting that most of our customers carry other
13 organic milk in addition to that which we supply.

14 Are you there referring to milk that is
15 offered by the retailer under a different label than the
16 one you supply?

17 A. Yes.

18 Q. Okay. You are not intending to suggest
19 that those customers carry milk in a brand that you
20 share in common with another distributing plant?

21 A. Right.

22 MR. VETNE: That's all the questions I
23 have. Thank you.

24 JUDGE CLIFTON: Thank you, Mr. Vetne.
25 Who next will cross-examine Ms. Keefe?

CROSS-EXAMINATION

1
2 BY MR. ENGLISH:

3 Q. Charles English. Good morning,
4 Ms. Keefe.

5 A. Good morning.

6 Q. It'd be fair to say that we've known each
7 other for a number of years, correct?

8 A. That would be right.

9 Q. I certainly respect and appreciate your
10 confidentiality, and I'm certainly going to not try to
11 go into such things. But I want to add that some of my
12 questions will necessarily go to what I hope is only
13 public information. I'm not seeking private information
14 from some of your professional things that you've done
15 having to do with Horizon. I'm not seeking private
16 information.

17 Were you at Horizon from 1996 until
18 Aurora began in 2003?

19 A. No, I was at Horizon from 1996 to 2001.

20 Q. Okay. And was Horizon a -- at first,
21 when it was formed, a privately-held company?

22 A. Yes.

23 Q. Okay. And were some of the owners of
24 Horizon, as a privately-held company, some of the owners
25 of Aurora today?

1 A. Yes. I would be one.

2 Q. And would another be Mark Retzloff?

3 A. Yes.

4 Q. And as a matter of public record, it is
5 that Horizon, while you were employed there, sought
6 exemption from the pooling and pricing provision of --
7 actually, at least the pooling provisions of Federal
8 Milk Orders from USDA, correct?

9 A. I believe that Horizon Organic Dairy as
10 well as others in the organic dairy industry sought
11 relief, frankly, more through the Congressional channel
12 than I would describe it as being from USDA. I mean,
13 there -- the organic dairy industry does not -- I've
14 never been to one of these before.

15 Q. Now you know why you sought exemption,
16 right?

17 A. So there wasn't a proposal put forward to
18 the Department like -- like what's going on here right
19 now.

20 Q. So you don't know whether Mark Retzloff
21 and others at first, before going to Congress, sought an
22 exemption from USDA?

23 A. No, I don't know that.

24 Q. But whether or not that happened, you do
25 know that the organic industry in general -- I'm happy

1 for that, more generalization -- the organic industry in
2 general, including the Organic Trade Association, sought
3 exemption from at least the pooling provisions of
4 Federal Milk Orders from Congress, correct?

5 A. Yes, that's correct. But I'd also note
6 that they --

7 Q. Weren't exactly successful?

8 A. That's correct.

9 Q. Just so the record may be clear here,
10 Aurora's location in Platteville, Colorado, is that in
11 Weld County?

12 A. Yes.

13 Q. It's true, is it not, today that Aurora
14 is not a producer-handler in all Federal Milk Orders,
15 correct?

16 A. Producer-handlers of Aurora's size are
17 treated as partially regulated distributing plants under
18 the Arizona order.

19 Q. And that came about effective May 1 of
20 2006, correct?

21 A. Yes, that's when the Milk Regulatory
22 Equity Act became effective.

23 Q. And it was as a result of the Milk
24 Regulatory Equity Act that your regulatory treatment in
25 Arizona changed, correct?

1 A. Yes. We are a producer-handler that is
2 treated as a partially regulated distributing plant in
3 Arizona.

4 Q. And as a partially regulated distributing
5 plant in Arizona, you are obligated to pay into the
6 Arizona pool the difference between the Class I price
7 adjusted for location to Weld County and the blend price
8 under the Arizona Order adjusted for Weld County,
9 correct?

10 A. Yes.

11 Q. And since the Market Administrator
12 publishes any information about any handler that is
13 delinquent or has not made its payments to the pool, and
14 since Aurora does not appear for any month on that list,
15 Aurora has been making that payment to the Arizona pool
16 back to the month of May 2006 for any distribution of
17 product in Arizona, correct?

18 A. We always comply with the Federal Milk
19 Market Order regulations.

20 JUDGE CLIFTON: And so the answer is yes?

21 THE WITNESS: Yes.

22 JUDGE CLIFTON: Thank you.

23 MR. ENGLISH: Thank you, your Honor.

24 BY MR. ENGLISH:

25 Q. And in addition, you are obligated on

1 that volume of milk to pay the assessment by the Market
2 Administrator pursuant to that section, correct?

3 A. Yes.

4 Q. And making that payment for the
5 difference between the Class I price and the blend price
6 adjusted to Weld County, Colorado, has not prevented you
7 from continuing selling in Arizona, has it?

8 A. Our Arizona sales are a very small
9 portion of our total sales. Frankly, we have the sales
10 in Arizona because they're important to the customers
11 that we service there, and it is -- we have been able to
12 continue to sell in Arizona.

13 But what is at issue here is not of the
14 same order of magnitude. And they're just not the same.

15 Q. But on that volume of milk that you're
16 selling in Arizona, you are able to pay the pool the
17 difference between the Class I and the blend, adjusted
18 to Weld County, Colorado, and still sell the product in
19 Arizona, correct? Yes or no?

20 A. Yes. As I stated, we sell product in
21 Arizona.

22 MR. ENGLISH: I have no further questions
23 of this witness.

24 JUDGE CLIFTON: Thank you. Let's go off
25 record just a moment.

1 (Off the record.)

2 JUDGE CLIFTON: We're back on record at
3 11:11. Who will next cross-examine Ms. Keefe?
4 Mr. Beshore.

5 MR. BESHORE: Thank you, your Honor.

6 CROSS-EXAMINATION

7 BY MR. BESHORE:

8 Q. Good morning, Ms. Keefe. Marvin Beshore
9 for National Milk Producers Federation and Dairy Farmers
10 of America.

11 A. Good morning.

12 Q. Have you been working in the organic
13 industry continuously since 1996?

14 A. No. I -- between 2001 and 2003, I was at
15 University of Colorado, where I got my MBA.

16 Q. Okay. So you were with Horizon from '96
17 to 2001 then?

18 A. That's correct.

19 Q. Okay. And then 2003 you began with
20 Aurora?

21 A. That's correct.

22 Q. Okay. What was the status of Aurora in
23 2003 when you were first employed?

24 A. When I -- when I joined Aurora in 2003,
25 the company was beginning to -- we were beginning the

1 organic transition of our dairy farm in Platteville,
2 acquiring the funding to build a processing plant. And
3 so at that time we would have been a conventional dairy
4 producer until we completed the organic transition.

5 Q. Okay. So in 2003, the company, Aurora
6 Organic Dairies -- is it Aurora Organic Dairy, Inc.? Is
7 that the legal entity?

8 A. The legal entity is Aurora Dairy
9 Corporation. Aurora -- we do business as d/b/a Aurora
10 Organic Dairy.

11 Q. Okay. Was Aurora Dairy Corporation then
12 in existence in 2003, I assume, when they employed you?

13 A. Yes, they were. What happened in 2003
14 was a -- an investor was brought in in order to -- the
15 company was re-formed and recapitalized in order to go
16 in a very different direction than where -- where --
17 what has been going on in the past. And the new company
18 was formed in 2003. And I'm part of the new company.

19 Q. The new company?

20 A. Yeah.

21 Q. Okay. So the company, the old company,
22 in 2003 was essentially a dairy farm at that time?

23 A. Yes.

24 Q. And was there more involved than that?

25 A. There was -- no. I mean, we were

1 dairy -- we were dairy producers when we started, and
2 that's -- and then we've built what I described.

3 Q. How big was the dairy operation in 2003?

4 A. That's actually a difficult question to
5 answer because when -- the -- before we began the
6 organic transition, the conventional herd was very
7 heavily culled for a variety of different reasons. And
8 then we -- but it was a fair-sized dairy farm. If
9 memory serves, it would have been milking about 3,000
10 cows or so.

11 Q. Okay. Now, presently -- so is that like
12 on one farm in Colorado --

13 A. That was.

14 Q. -- or more than one farm in Colorado?

15 A. It's -- it was one farm in Colorado that
16 had multiple herds and so not all herds were taken
17 through the transition.

18 Q. Okay. Now, presently you have five farms
19 in Colorado and Texas, according to your testimony,
20 correct?

21 A. That's right.

22 Q. Now, are all those farms owned by the
23 corporation?

24 A. All of the farms are operated by the
25 corporation. We own some of the farms and we lease some

1 of the farms, but they're all operated by us. We own
2 all of the cattle so it's -- you know. But we're not --
3 we don't -- in some cases we have capital leases for the
4 farms -- for the farm instead of owning it and having a
5 mortgage with the bank.

6 Q. Okay. When you had the infusion of
7 outside equity, is that when the decision was made to
8 vertically integrate?

9 A. Yes.

10 Q. Were you involved in that decision-making
11 process?

12 A. I was involved, but it was not my
13 decision.

14 Q. Okay. Was anyone involved who knew
15 anything about Federal Milk Marketing Orders?

16 A. Out of everyone involved, I knew the most
17 at that time about Federal Milk Marketing Orders.

18 Q. And tell us again what your involvement
19 was in that decision-making?

20 A. I was part of a team of people that were
21 trying to decide what -- what a good opportunity would
22 be within the organic milk category. And I identified
23 that the private label segment was underserved and set
24 about trying to structure a business that we thought
25 could most ably serve that market.

1 Q. Did you look at options other than
2 building your own processing plant?

3 A. Yes, we looked at whether or not it would
4 make sense for us to co-pack the product, to work with
5 the mechanics of an organic dairy producer, you know,
6 have someone in the middle, and we would be on both
7 sides of it.

8 Q. Okay. And what went into the decision to
9 build a plant rather than co-pack?

10 A. The decision to build a plant rather than
11 co-pack was one primarily of control and traceability.
12 A number of us that were involved in the startup of
13 Aurora Organic Dairy had some, frankly, negative
14 experience with fluid milk co-packers and didn't believe
15 that that was a very effective way to serve the private
16 label market.

17 We'd also heard, you know -- you know, as
18 I indicated, this was a fairly substantial undertaking.
19 \$35 million is a lot of money. And we -- we didn't --
20 we didn't go into this blindly without some idea of
21 what -- what the retailers wanted on the other side of
22 it. And one of the things that they wanted was
23 dependability.

24 We heard a lot about dependability,
25 reliability, control, and so we wanted to make sure that

1 what we were offering had those features.

2 Q. Okay. Were you aware in 2003 -- now, you
3 were the -- you were the regulatory expert on the team,
4 correct?

5 A. I was.

6 Q. Okay. You were the only one who knew
7 anything about Federal Milk Marketing Orders?

8 A. I wasn't the only one who knew anything
9 about Federal Milk Marketing Orders. But my
10 knowledge -- I had the most knowledge of the orders, but
11 I think that everyone on the team, save maybe the farm
12 operations person, would know what FMMO stands for.

13 Q. Were you -- as the most knowledgeable
14 person, were you aware in 2003 of the hearings that
15 began at that time in the -- concerning the Arizona,
16 Pacific Northwest marketing orders?

17 A. No, I wasn't.

18 Q. Okay. Did you become aware of them at
19 any time?

20 A. I became aware of them later on. I first
21 realized how contentious the producer-handler's place
22 within the dairy industry is when -- in 2005 and 2006,
23 in the run up to the Milk Regulatory Equity Act being
24 passed.

25 Q. Okay. Now, what led -- what led Aurora

1 to expand from -- up to the 12,000 cows that you
2 identified today?

3 Now, you started out with a herd that was
4 3,000 and then was culled heavily, I think you
5 indicated, from that, correct? Culled down to what
6 level?

7 A. I don't remember.

8 Q. Okay. Well, you started with less than
9 3,000 cows in 2003. Did your business model at that
10 time project expanding to the 12,000 you have today?

11 A. Our business model at that time did
12 project expansion, as the plant that we built was as
13 small as we could do it for what we wanted to make, and
14 the amount of milk that could be processed in the plant
15 was more than the amount of milk that could be supplied
16 by the initial farm. And so yes, we contemplated
17 expansion from the beginning.

18 We have subsequently done a modest
19 expansion of the plant's capacity, so at that time the
20 plant was sized so that we could -- so that we would be
21 looking at more like 8 to 10 thousand cows in milk.
22 Some of it has to do with the mix of the products
23 running through the plant and all of the rest of that,
24 so it gets complicated quickly.

25 Q. Is the plant presently running at

1 capacity?

2 A. No.

3 Q. Over the last year has it run at capacity
4 at any time?

5 A. Yes.

6 Q. What's your monthly milk production from
7 12,000 cows?

8 A. As I indicated to Mr. Vetne, I'm not
9 willing to discuss that.

10 Q. Okay. Is Dr. Juan Velez an employee of
11 Aurora?

12 A. Yes, Dr. Velez is responsible for our
13 milk production.

14 Q. Does he know the milk production per cow?

15 A. I also know the milk production per cow.
16 I'm not willing to discuss it.

17 Q. I understand that. But Dr. Velez, as the
18 marketing person at the farm, does he know the milk
19 production per cow?

20 JUDGE CLIFTON: Mr. Ricciardi.

21 MR. RICCIARDI: Mr. Beshore knows better
22 than that. The objection is, how in the world
23 can she know what he knows? It's speculation
24 and calls for speculation from this witness, and
25 obviously we don't want that kind of information

1 in the record.

2 JUDGE CLIFTON: Well, maybe she read it
3 in the newspaper. Mr. Ricciardi, I'm just being
4 facetious. You know that.

5 MR. RICCIARDI: I understand that, Judge.
6 Apparently the newspaper is the standard. I
7 didn't know that.

8 JUDGE CLIFTON: Mr. Beshore, you may
9 establish whether this witness knows what
10 Dr. Juan Velez knows about the monthly milk
11 production of the cows.

12 BY MR. BESHORE:

13 Q. What are Dr. Velez's responsibilities
14 with Aurora?

15 A. Dr. Velez is responsible for our farm
16 operations.

17 Q. And by that, all five farms?

18 A. Yes.

19 Q. Okay. So he is the chief operating
20 officer of the milk production program of Aurora Dairy?

21 A. He'd like that title. Yes.

22 Q. Okay. In his capacity, do you think he
23 knows how much production he gets per cow?

24 MR. RICCIARDI: Your Honor, do I have to
25 step up or can I have my last objection read

1 back?

2 JUDGE CLIFTON: I'd like you to say it
3 again.

4 MR. RICCIARDI: Your Honor, Mr. Beshore
5 knows better than that. It is calling for
6 speculation. How in the world does she know
7 what he knows based upon that question?

8 MR. BESHORE: Well, I would note that
9 she's a corporate representative testifying in
10 that capacity.

11 JUDGE CLIFTON: Just ask her if she knows
12 whether Dr. Velez knows.

13 MR. RICCIARDI: That would be a good
14 question.

15 MR. BESHORE: I will adopt the Judge's
16 question, Ms. Keefe.

17 THE WITNESS: Could you --

18 JUDGE CLIFTON: You need to ask the whole
19 question.

20 Q. Do you know if Dr. Velez, the operations
21 manager of the farms, knows the milk production per cow?
22 I'm asking for an annual figure that he gets at those
23 farms.

24 A. Yes. Dr. Velez, as well as myself and
25 the other members of the management team, are well aware

1 of our milk production per cow, per day, et cetera. But
2 I'm not willing to discuss confidential business
3 information.

4 Q. As to whether that information is
5 confidential, are you aware -- were you here when
6 Ms. Arnold testified, when the organic handlers
7 testified?

8 A. No, I was not.

9 Q. Let me represent to you that there was a
10 panel of organic dairy farmers that testified, and one
11 of them testified to a visit to one of Aurora's farms at
12 which Dr. Velez spoke to these outsiders about their
13 milk production per cow.

14 Now, he, according to his testimony, told
15 everybody what the milk production per cow was. And I
16 suggest to you that it's not really -- that would
17 suggest it's not really a confidential matter.

18 With that understanding, are you willing
19 to provide for this record the information that you've
20 said you have about milk production per cow?

21 JUDGE CLIFTON: Mr. Ricciardi.

22 MR. RICCIARDI: I was hoping there was a
23 question in our future. The fact is, Judge, the
24 lead-up to that is asking this witness to
25 speculate about what testimony we got in this

1 record from somebody who might have had a
2 conversation, who might have had another
3 conversation with a third person. We're in
4 totem pole hearsay. I think we're at about the
5 level of four. And I don't think that this is a
6 fair question and this record doesn't need it.

7 And it's, by the way, not very relevant
8 at this point either. So those would be my
9 objections.

10 JUDGE CLIFTON: All right. Let me chime
11 in a bit. That witness did state what the group
12 that she was part of had been told by Dr. Velez.
13 As it is now -- since Dr. Velez has not been a
14 witness here, there's been no way to test that
15 evidence to see if that is, in fact, what
16 Dr. Velez would say he said, or whether that's
17 what Dr. Velez now believes. So you have the
18 opportunity to present evidence on that issue if
19 you want, but it's entirely up to you.

20 Mr. Beshore, go ahead and ask a question.

21 MR. BESHORE: I did.

22 JUDGE CLIFTON: Do you want it read back
23 or do you want to ask it again?

24 MR. BESHORE: I'll ask it again.

25 BY MR. BESHORE:

1 Q. In view of the fact that there's been
2 testimony here about what Dr. Velez told these outsiders
3 what was Aurora's production per cow, would you now
4 testify for this record that nonconfidential information
5 as to Aurora's production per cow, an annual figure?

6 A. No. I'm not willing to discuss our
7 annual production per cow.

8 Q. Okay. You said that there are 12,000
9 cows, and those are the cows in milk, correct?

10 A. Yes. That's on the average.

11 Q. On average, right. And you also
12 indicated, if I got your testimony correct, that there
13 would be approximately 3,000 cows dry at any time?

14 A. On the average.

15 Q. On average?

16 A. (Nodding head.)

17 Q. Okay, just looking for average. Not
18 asking for precision to the cow.

19 When we're -- so there are roughly, on
20 average, 15,000 milking-age cows, milking head of cows
21 in the Aurora herd?

22 A. Yes, that would be the total across all
23 of the herds.

24 Q. Okay. So if one wished to estimate the
25 total production annually from the herd, you would use

1 the total head, the total numbers of milking head,
2 against an annual figure to come out with a total gross
3 production from the herd, correct?

4 A. Could you state that again? I'm not
5 totally following the math.

6 Q. Okay. Well, when -- production per cow
7 in a dairy herd, when that figure is used, it includes
8 all cows in the herd, knowing that at any given month
9 during the year every cow is going to be dry for some
10 period during the year, correct?

11 A. Yes, every cow is going to be dry for
12 some period of time during the year. I think it's
13 well-known within our industry whether you're -- you can
14 look at pounds per cow per day when the cow's in milk.
15 You can look at rolling herd averages versus the total.
16 You know, I don't know what this is adding.

17 Q. But when you're looking at the total
18 production in a herd, you use the number of cows, which
19 includes the total herd, not just the number that
20 happened to be milking at any given time?

21 A. That's -- yeah -- I mean, that's one way
22 you can do the math. You can get to the same number in
23 a different way, too.

24 Q. If we were working with production per
25 day, you'd get it in a different way?

1 A. Yeah.

2 Q. Okay.

3 A. I'm not particularly familiar with
4 rolling herd average. I think about it more in terms of
5 pounds per cow per day in the tank for me.

6 Q. Do you care to share that number?

7 A. No, I don't.

8 Q. Okay. You say Aurora Organic Dairy is a
9 leading supplier of private label and store brand
10 organic milk. Do you have your own label at all?

11 A. We have what's known in the trade as a
12 control brand. It's called High Meadow. Sometimes
13 customers will want to -- will want to see if -- see if
14 it's a good idea or not. And so they might -- they
15 might pick up High Meadow and then convert it over to
16 their brand later -- convert to their brand later on, so
17 the --

18 Q. Other than the High Meadow brand, all
19 your fluid milk products are packaged under private
20 label or store brands?

21 A. Yes, that's correct.

22 Q. Okay. When you're dealing with large
23 regional and national customers that you've -- as you've
24 indicated you do, they may have, and probably would
25 have, one store brand throughout all their -- all their

1 stores?

2 A. Some would, some wouldn't. I mean, they
3 don't always use the same brand for organic versus
4 conventional. Some of them have multiple in-house
5 banners. There's a wide variety of things out there.

6 Q. I guess my question is, do you package in
7 a store brand or a private label which -- under which
8 other -- some of your competitors also package for
9 customers?

10 A. There are some national accounts where we
11 are not the sole supplier. However, that's always the
12 customer's choice, frankly. We prefer to be the sole
13 supplier, but that's, you know, not -- it's not up to
14 me.

15 Q. I understand that. It's up to the
16 customers?

17 A. It is up to the customers.

18 Q. And you prefer to be sole supplier, which
19 I understand. I'm sure your competitors prefer to be
20 sole suppliers as well. But it's not unusual for a
21 national or large regional customers to have more than
22 one supplier for certain private labels or store
23 brands -- store brand lines, correct?

24 A. It's not unusual. I mean, they look at
25 it lots of different ways. They may not want to be

1 dependent on one vendor. They may want to -- they
2 may -- they may want to look at it in terms of different
3 regions of the country.

4 So there's -- you know, there's lots of
5 different things out there. But that's the customer's
6 choice. You know, it's not -- not my choice.

7 Q. Correct. Now, I understand that. I'm
8 just trying -- you have a lot of knowledge about how --
9 the marketplace out there.

10 A. Thank you.

11 Q. And that's what I'm trying to learn for
12 the record here.

13 So some of those accounts may have -- you
14 may share some of those accounts. Although you'd like
15 to have them all, be the only supplier, you may share
16 some of those store brands or private label accounts
17 with Horizon Organic for some customers?

18 A. No. However, I want to note that I'm not
19 aware of anyplace where we're supplying a private brand
20 at the same time that they're buying it from somebody
21 else through the same distribution center into the same
22 store.

23 Q. Okay.

24 A. It's -- it's much more -- I'm -- I'm
25 concerned. I feel like you are oversimplifying it a

1 little bit. And it's -- their vendor selection
2 decisions are at times complex and mysterious.

3 Q. Okay. So they may be -- you may share on
4 a regional basis, is that --

5 A. Yes, I might supply one region of a
6 national retailer and another vendor might supply a
7 different region.

8 Q. Okay. And those vendors could be Aurora
9 and Horizon, Aurora and Organic Valley or Aurora and HP
10 Hood or a combination of those?

11 A. And others as well. There are some
12 smaller folks supplying as well.

13 Q. Now, on page 2 of your statement,
14 Exhibit 88, you've indicated that you balance your milk
15 in a number of different ways. And I'm just wondering
16 if you could tell me -- tell us a little more about what
17 you mean by balancing item number 1, careful management
18 of our finished goods inventory.

19 A. We are primarily a processor of extended
20 shelf life ultra pasteurized organic milk. Because the
21 shelf life of UP milk is longer than that of HTST, high
22 temperature, short time milk, we can -- we can float the
23 peaks and valleys over the course of a week or two.

24 And so we -- we very -- we very carefully
25 manage that inventory. And, frankly, we maintain a

1 higher inventory, I believe, than other -- than other UP
2 processors because since we're self-supplying, I have to
3 be able to hit the peak.

4 And so -- so we're keeping -- we're
5 keeping more days in inventory. We have more working
6 capital tied up in that.

7 Q. Okay. By hit the peak, you mean the peak
8 of customer/consumer demand?

9 A. I mean to hit the peak of customer
10 orders. The -- the cows are a lot more steady than the
11 customers.

12 Q. So you believe that you carry more
13 inventory than some other processors, more finished
14 goods?

15 A. I think so.

16 Q. Do -- is price a factor in managing your
17 inventory at all?

18 A. I don't understand. Could you expand the
19 question?

20 Q. Do you use the price at which you sell
21 your products as a factor in managing your inventory?

22 A. Do you mean do we adjust the price in
23 order to move more inventory?

24 Q. That might be one -- that might be one
25 way in which you could use price.

1 A. No. Our agreements with our customers
2 don't allow us to move the price like that. You can't
3 do that.

4 Q. Does your price move monthly?

5 A. No.

6 Q. It's fixed over a long period?

7 A. Yeah. It's -- our prices are agreed to
8 in advance over the course of -- and they need to be
9 adjusted over the course of long periods of time, not
10 monthly.

11 And we have to provide advance
12 notification -- advanced notification as well on,
13 generally, anywhere from 30 to 90 days of a price
14 change. So the time horizon for the two things, they
15 don't match up. I can't change the price fast enough to
16 affect the inventory.

17 Q. Very good. You've also indicated that
18 you balance your milk by -- this is point number 2,
19 production of butter and powder at co-packers. Now, do
20 I understand that your plant processes only fluid milk
21 products?

22 A. Yes. That's correct.

23 Q. Okay. And you don't make any what we
24 call Class II products, cultured products at your plant?

25 A. No, we do not.

1 Q. Okay. When you're referring to
2 co-packers with respect to production of butter and
3 powder, those are manufacturing facilities owned by
4 other companies?

5 A. Yes.

6 Q. Now, if you occasionally -- very
7 occasionally are -- are you ever short of milk?

8 A. Yes.

9 Q. It's possible to buy certified organic
10 milk from pool sources, is it not?

11 A. It is -- it is possible to buy limited
12 amounts of certified organic milk from pool sources.
13 And my understanding, for us to remain in compliance
14 with the requirements of the Central Order, that any
15 milk that I do purchase from outside my own sources
16 actually has to be from a pooled source.

17 Q. Just so there's no question then --
18 because there was something in your statement that
19 suggested, to me at least, that certified organic milk
20 might not be available for pooled sources -- it is
21 available and you do source occasional loads when you
22 need them from pool sources as required by the Order,
23 correct?

24 A. We occasionally purchase up to but not
25 more than 150,000 pounds, but there's a big difference

1 between buying three bulk trailer loads of milk and the
2 amount of milk produced by 12,000 cows, no matter how
3 you do the math.

4 Q. You're producing a lot more than that?

5 A. Yes.

6 Q. Okay. Now, you say the cost of
7 production is about \$30 per hundredweight at your farms.
8 Do you have any information that would suggest that the
9 cost of production of certified organic milk on pool --
10 on farms that are pooled on the Federal Order, let's
11 take Order 32, is any less than your cost of production?

12 A. I'm not aware of any -- of any studies or
13 anything like that that have looked at other -- the cost
14 of production for any other organic producers --

15 Q. Okay.

16 A. -- in the geographic regions of the
17 Central Order, no.

18 Q. Okay. With farms that -- of the size of
19 15,000 milking head, milking --

20 A. Mature head.

21 Q. -- mature head, you've got some
22 significant economies of scale in the production of your
23 milk supply, do you not?

24 A. We enjoy economies of scale on our farm
25 production, but I would agree with the -- with the dairy

1 literature that suggests that there's a point in time at
2 which the economies of scale in farm production begin to
3 drop off, that you -- that your herds get bigger, but
4 you stop seeing a decrease in production costs.

5 Q. And where do you feel like -- on the
6 basis of the literature and your own experience, where
7 do you feel that point is?

8 A. I feel like the point changes around a
9 thousand cows or so.

10 Q. When you were answering a few questions
11 from Mr. Vetne about how you calculate your costs, I
12 think he suggested -- I just want to make sure I didn't
13 misunderstand him or you on this, that you suggested in
14 response to his questions that as far as farm level
15 costs, that you depreciated the farm?

16 A. The \$30 a hundredweight includes the --
17 it includes the depreciation and the amortization as
18 well as the interest expense, so it's all there, which
19 isn't apparently the norm.

20 Q. Okay. But not actually considering that
21 the land is depreciating in value and charging that as
22 an expense of your production?

23 A. What we're looking at there is the
24 depreciation for the -- related to the facilities on our
25 farm.

1 Q. The buildings and equipment?

2 A. (Nodding head.)

3 JUDGE CLIFTON: Did you respond to his
4 question, building and equipment?

5 THE WITNESS: Yes.

6 Q. Your statement says on page 6 -- and
7 maybe we've covered this a bit -- but it says, most of
8 our customers -- this is the first full paragraph at the
9 top: Most of our customers carry other organic milk in
10 addition to that which we supply.

11 Do you see that sentence?

12 A. I'm sorry. Which page are you on?

13 Q. Page 6, the first full paragraph at the
14 top. I'm looking at that.

15 JUDGE CLIFTON: And what sentence do you
16 want her to focus on?

17 MR. BESHORE: The sentence -- I'll just
18 read it.

19 BY MR. BESHORE:

20 Q. In addition, it is also worth noting that
21 most of our customers carry other organic milk in
22 addition to that which we supply. It's the second
23 sentence preceding --

24 A. Is it after the bullet point? I think
25 I'm just a little confused as to where you are.

1 Q. Yeah, it's the paragraph below the bullet
2 point.

3 A. Okay.

4 Q. Okay? It's the second to last sentence.
5 It's the fourth sentence in the paragraph. It says: In
6 addition, it is also worth nothing that most of our
7 customers carry other organic milk in addition to that
8 which we supply, okay?

9 A. Uh-huh.

10 Q. Now, setting aside in California -- by
11 the way, do you have distribution out in California?

12 A. Yes, we do.

13 Q. Setting aside California, because it's
14 not part of the Federal Order System, when you are
15 supplying customers in the Federal Order System, those
16 other suppliers are, you know, almost universally from
17 pooled sources, correct?

18 A. Sometimes, but not always.

19 Q. What are the nonpooled -- other nonpooled
20 sources of organic milk? Are there any major -- major
21 ones?

22 A. There's a major -- I believe that there's
23 a major organic milk processing plant in Nevada.

24 Q. Okay. And that's not federally
25 regulated, so they would have some supplies in some

1 Federal Order areas, is that your testimony, to
2 customers in some Federal Order areas?

3 A. I think so. I mean, you're asking a very
4 broad question.

5 Q. Right. Well, your statement is very
6 broad: Most of our customers carry other organic milk
7 in addition to that which we supply.

8 I'm trying to get a little more detail on
9 that. By the way, you supply customers in Federal Order
10 1, correct?

11 A. Yes.

12 Q. Okay. Federal Order 5?

13 A. It would -- could you use the -- the
14 names and the numbers?

15 Q. Sure, I'd be happy to. Okay. Maybe we
16 can do it really easily. Do you supply milk in every
17 Federal Order?

18 A. Not in every month.

19 Q. Okay. But in some months, you have
20 supplied milk in every Federal Order?

21 A. At some point we've had sales in every
22 single Federal Order. We also have sales in unregulated
23 areas, and we also have sales in California.

24 Q. Okay. How many Federal Orders do you
25 have regular sales in, basically every month, on an

1 ongoing basis? I'll start with the Northeast is Federal
2 Order 1. Would that be sales every month?

3 A. Uh-huh.

4 Q. Yes?

5 A. Yes.

6 Q. Okay. The Appalachian Order, Federal
7 Order 5?

8 A. No.

9 Q. Okay. The Southeast Order, Federal Order
10 7?

11 A. In between. So not always, but most of
12 the time.

13 Q. That goes as far as Arkansas -- I mean,
14 goes as far west as Arkansas and the southern portion of
15 Missouri?

16 A. Are you on 6 or 7?

17 Q. 7.

18 A. Oh, that's -- 7 is all of the time. 6 is
19 some of the time.

20 Q. 6 being Florida, some of the time. 7 all
21 of the time, however?

22 A. Uh-huh.

23 Q. That's yes?

24 A. Yes.

25 Q. Thank you. 126, the Southwestern Order,

1 which is Texas?

2 A. We have sales in Texas all the time.

3 Q. Arizona, the small -- the limited --
4 somewhat limited, I guess, sales that you referred to
5 with Mr. English, all the time?

6 A. Yes.

7 Q. Okay. And Order 32, all of the time?

8 A. Yes.

9 Q. Order 30, the Upper Midwest Order?

10 A. Some of the time.

11 Q. Okay. The Order 124, the Pacific
12 Northwest Order?

13 A. All the time.

14 Q. Order 33, the Mideast Order, that would
15 include Ohio, Indiana, Michigan and a little bit of
16 Kentucky and West Virginia and Western Pennsylvania?

17 A. All of the time.

18 Q. Okay. Thank you. Have you calculated
19 what Aurora's pool obligation might be if you were a
20 fully regulated handler in the Federal system, Federal
21 Order System?

22 A. I've tried to estimate it, but we -- you
23 know, I'm not quite sure -- I don't know exactly what it
24 would be. But it would be millions of dollars a year
25 for us.

1 Q. It would be millions of dollars a year?

2 A. Yes.

3 Q. What are the total annual sales of
4 Aurora?

5 A. We don't release that information
6 publicly.

7 Q. Now, you make the statement on page 8,
8 the last page of your testimony that: Some of the
9 proposals, frankly, punish vertical integration in any
10 form other than a cooperative.

11 And I'm interested in what -- in what you
12 might mean there. You have been here for some of the
13 portions of the testimony, correct?

14 A. Yes, I've been here for some portions of
15 the testimony over the course of the past couple of
16 weeks.

17 Q. Okay. Were you here when Mr. Lee from
18 Prairie Farms testified?

19 A. No.

20 Q. Okay. Let me suggest he's -- Prairie
21 Farms is a cooperative. Are you aware of that?

22 A. Yes.

23 Q. Okay. And they're also a processor?

24 A. Uh-huh.

25 Q. Okay. And their plants are fully pooled

1 and subject to all the pricing regulations of the order.
2 Are you aware of that?

3 A. No. But I'll take your word for it.

4 Q. Okay. Well --

5 MR. VETNE: Excuse me, your Honor, that
6 misstates the record.

7 JUDGE CLIFTON: Mr. Vetne, I'll hear you.

8 MR. BESHORE: Sorry, Central Dairy.

9 MR. VETNE: Got it. Go ahead.

10 MR. BESHORE: Okay.

11 JUDGE CLIFTON: See, I love this bar. I
12 absolutely love the lawyers who do these
13 hearings. You are so knowledgeable. My hat is
14 off to you. Mr. Beshore, begin again.

15 BY MR. BESHORE:

16 Q. Okay. Just accept that Prairie Farms
17 owns and/or operates a number, and I don't -- I won't
18 give the number because I don't know -- can't
19 recapitulate the precise number, but, you know, more
20 than a half dozen fully regulated pool plants, that the
21 cooperative, the farmers own -- own those plants and
22 they are fully priced and pooled under the order. That
23 was his testimony --

24 A. Uh-huh.

25 Q. -- okay? Now, your statement seems to

1 suggest that this proposal -- the proposals, and you're
2 talking there about -- when you make the statement on
3 page 8, you are talking about Proposals 1, 2, and 26, I
4 assume?

5 A. Yes.

6 Q. Okay. That they would punish vertical
7 integration in any form other than a cooperative. Now,
8 if the cooperative processor is already fully pooled and
9 regulated, and the effect of this proposal would just
10 make Aurora fully pooled and regulated, how is that
11 punishing your vertical integration?

12 A. I believe that if Proposals 1, 2, and 26
13 were adopted, the most advantageous vertical integration
14 position to be in would be that of a cooperative, not
15 that of a producer-handler.

16 Q. Okay. How -- what do you understand
17 about cooperative vertical integration? What aspects of
18 that are you addressing there?

19 A. I'm -- I don't know a lot about
20 cooperative vertical integration. But as -- as a former
21 cooperative dairy producer, I observed tremendous --
22 that the cooperatives had tremendous market power, both
23 with their procurement with their producers as well as
24 the sales with the customers. And the ability of the
25 ways in which cooperatives are able to negotiate

1 over-order premiums, producer prices and the like, it's
2 a little different than what the way our business works.

3 Q. Well, the difference right now is those
4 plants have to pay into the pool and you do not have to,
5 correct?

6 A. I think there's a lot of other
7 differences between a cooperative and my business.

8 Q. But that's the difference that you want
9 to maintain?

10 A. It's actually one of the differences I
11 want to maintain.

12 Q. That's the difference that's involved in
13 this hearing that you want to maintain, correct?

14 A. That's correct.

15 Q. Yes.

16 MR. BESHORE: Thank you very much.

17 JUDGE CLIFTON: Thank you, Mr. Beshore.

18 Is there other cross-examination for Ms. Keefe?

19 Let me begin with Mr. Yale.

20 CROSS-EXAMINATION

21 BY MR. YALE:

22 Q. Benjamin F. Yale for Continental Dairy
23 Products and Select Milk. Good after -- good morning,
24 still.

25 A. Oh, excellent. Good morning.

1 Q. I'm not guaranteeing you it'll stay that
2 way before you get off, but good morning.

3 I kind of want to follow up. There were
4 some questions on the retail that Mr. Beshore asked.
5 And I just want to make sure that that's clear.

6 You've been through some of this hearing
7 this week, right? You've heard some of the testimony?

8 A. Yes.

9 Q. And maybe you've read some testimony?

10 A. Yes.

11 Q. All right. And you understand that one
12 of the contentions is that producer-handlers, there's
13 a -- a scheme or a model or whatever where a producer
14 delivers to a store under the store name all the milk
15 that the producer-handler can, and if that's not enough
16 for the store, the store goes out and buys it from a
17 pool plant or some other source and uses the same label
18 so that the consumer thinks they're getting the same
19 milk, but, in fact, it comes from two different sources.
20 You are aware of that? You've heard of that?

21 A. Yes, I've heard of that.

22 Q. All right. And that -- the contention is
23 that, in fact, the pool plant is balancing the supply of
24 that producer-handler under that scheme? I mean,
25 that's -- you've heard that?

1 A. I've heard that contention. But in my
2 experience with our private label customers, that's not
3 the way that it works at all.

4 Q. Okay. And that's what you were saying.
5 Although there may be multiple sources of the same brand
6 to the same customer, but it's not at the same location
7 at the same time?

8 A. That's right.

9 Q. All right. You would not walk into any
10 of your customers' stores and see the same brand with
11 different plant numbers on it?

12 A. That would be -- that would be unusual
13 for the same size format. But you might see -- you
14 might see the same brand with one vendor supplying half
15 gallons, another vendor supplying gallons, another
16 vendor supplying the -- the heavy creams and half and
17 halves and the like.

18 I mean, that's the customer's choice as
19 far as which -- which supplier is the best fit for --
20 for the product.

21 Q. And do you think that in some ways is
22 somewhat unique, though, because it's organic or --

23 A. I don't have any reason to believe that
24 it behaves that much differently than conventional. But
25 I recognize this has been the subject of great debate.

1 Q. Now, at the top of page 7 you asked a
2 number of, I guess, rhetorical questions. And I kind of
3 got -- getting kind of the music or something that comes
4 through with this. The bigger picture is that -- are
5 you suggesting that in reality organic milk and
6 conventional milk really are two completely different
7 products?

8 A. Yes.

9 Q. So that the mechanisms that are set up to
10 balance -- let me -- I want to -- let me back off that.
11 I want to ask you another question that I was intrigued
12 about. The concept -- I hadn't really thought of it but
13 it kind of made sense during your testimony. You talk
14 about you have UHT, which is ultra high temperature
15 packaging?

16 A. Yes.

17 Q. And extended shelf life?

18 A. Yes, our pasteurization process is -- for
19 the most part, most of the milk that we sell is UHT
20 pasteurized, ultra high temperature. And then our
21 fillers are ESL fillers, extended shelf life fillers.

22 Q. All right. You don't do any standard
23 pasteurization?

24 A. We do do some of that, a small amount.
25 That is, again, the customer's choice.

1 Q. Okay. So let's talk about that product
2 for a moment. The conventional pasteurization, are
3 there regulations in terms of how soon that product has
4 to be removed from your plant and in the store?

5 A. Well, there aren't regulations about how
6 soon it has to be removed from the plant and put in the
7 store. You can let it spoil in your racks and go out of
8 business quickly. Because a high temperature, short
9 time pasteurization isn't going to lead to the same
10 shelf life, you have to move it through your inventory
11 and to your customers much more rapidly. And it's much
12 more difficult to -- to use inventory as a balancing
13 tool for -- for an HTST milk.

14 Q. And the reason is because it has such a
15 short life, you've got to get it out into the store,
16 right?

17 A. Yes.

18 Q. So I'm not looking for specific or
19 proprietary information, but typically the high
20 temperature, short time pasteurization, the shelf life
21 is -- runs two weeks, ten days, what -- I mean --

22 A. In my experience, you know, day of fill,
23 two to three weeks would be a norm right now.

24 Q. Okay. And that's through the industry,
25 that's not just organic or not just --

1 A. Right.

2 Q. And then the extended shelf life is a
3 higher step. It's not necessarily UHT, right?

4 A. Right. There is a medium step where we
5 don't -- we don't do the medium step.

6 Q. Oh, okay. So your extended shelf life is
7 UHT?

8 A. Our extended shelf life product is UHT.
9 We do an ultra high temperature pasteurization and we
10 use ESL, extended shelf life, fillers. They are
11 extraordinarily expensive and extraordinarily clean.

12 Q. All right. Sometimes you talk about
13 aseptic packaging?

14 A. Right. We don't do aseptic packaging.
15 Ours -- our milk, when you see it in the store, is in a
16 gable-top carton. An aseptic process would take a UHT
17 pasteurized milk and then put it into an aseptic brick.
18 It's then shelf stable and doesn't even require
19 refrigeration. Our product does require refrigeration.

20 Q. The term brick refers to the box that
21 it's in. It's not a brick that you'd build a house
22 with, right?

23 A. No. They look like bricks.

24 Q. So typically the UHT shelf life would run
25 several months?

1 A. A UHT shelf life is typically going to be
2 at least 60, days but it's not going to be a lot longer
3 than that.

4 Q. Okay. Now, what does -- in the -- in the
5 stores there are -- different days of the week have
6 different sales volumes, is that correct?

7 A. Yes.

8 Q. All right. And by -- I think what you
9 were saying, by your inventory management, is that you
10 can have a steady supply of milk coming in, relatively
11 steady, and process it and UHT it and store it, and then
12 use that as kind of a balancing to meet those day-to-day
13 fluctuations and the store demands, is that what you
14 were saying?

15 A. That's correct.

16 Q. Which is not readily available to
17 conventional pasteurized milk, is that right?

18 A. It would be much more difficult to do it
19 with a HTST product because of the shelf life involved.

20 Q. And as a result, you don't have the need
21 for a balancing of the market for those day-to-day
22 fluctuations?

23 A. No, not for -- not for the day-to-day
24 fluctuation. But we do -- I -- I chose the word burden
25 of balancing, those words on purpose. We do expend a

1 great deal of money and a great deal of effort on
2 balancing over -- over the course of the months and
3 years. We happen to have a very unique tool for the
4 near term, for the days and weeks end of the equation,
5 as opposed to the months and years.

6 Q. So coming back to that comment in 7, is
7 that -- that the mechanisms, the balancing, the type of
8 product that you sell, the way it's marketed, and, in
9 fact, it -- well, let me back up.

10 Organic has -- I think you've testified,
11 has a specific standard of identity by USDA's standards,
12 right?

13 A. That's correct. In order for your milk
14 to be labeled with the USDA organic seal, it must be
15 produced and certified in accordance with the National
16 Organic Program regulations.

17 Q. So the way I understand the thing, what
18 you're saying is these -- all these systems that we've
19 designed to protect producers and processors in
20 conventional milk really do not apply to the niche with
21 the organic and the way that you're set up, is that --

22 A. It frequently feels like a square peg in
23 a round hole.

24 Q. Now, do you know what percentage of
25 organic milk is produced by producer-handlers nationwide

1 as compared to that that's pooled?

2 A. I have no idea.

3 Q. Is the ratio -- do you know whether the
4 ratio is higher than conventional milk in terms of PD to
5 the regulated? Or would you have any -- do you have any
6 way of even guessing?

7 A. I don't really know. I do notice that
8 there are -- there are a lot of -- there are a lot of
9 exempt plants that are processing organic milk. And I
10 think that many of them are actually producer-handlers
11 that are exempt because of where their sales volume is
12 at.

13 And then also within organic there's a
14 great deal of interest in artisan farmstead cheese.
15 Again, that's a little different, you know, own-farm
16 value added sort of thing.

17 Q. Your request doesn't ask the Department
18 to exempt from the pricing regulations organic milk,
19 right, because it's organic?

20 A. No. That's not the issue at hand here.

21 Q. Okay. In the Class I price in series
22 that USDA reports from the various markets, is that used
23 in the establishing of the pricing of your milk
24 products?

25 A. No.

1 Q. And one final question. There was a --
2 again, almost a rhetorical comment or question made by a
3 witness earlier -- I guess it may have been last week, I
4 can't remember; it's all starting to blend -- that he
5 said he'd like to see how you could pasture a thousand
6 cows on ground. Do you remember that? Do you recall
7 anything that was said to that?

8 A. I don't remember that.

9 Q. But, in fact, your farms, you do have --
10 they have some very, very, large acreage, is that right?

11 A. Yes. We do. Our farms are surrounded by
12 over 4,000 acres of pasture.

13 Q. So on a beautiful blue day -- sky day
14 with a few clouds in West Texas, one can go to that farm
15 and see this fantastic sight of thousands of black and
16 white Holsteins walking through this deep green field,
17 is that true?

18 A. Yes, and you'll also see some Jerseys and
19 some crossbreds.

20 Q. Okay. I didn't want to leave out the
21 other herds. I wasn't trying to be discriminatory. But
22 it does happen and it is happening, and it's a very
23 beautiful sight?

24 A. It's a truly wonderful thing.

25 MR. YALE: Okay. I have no other

1 questions.

2 JUDGE CLIFTON: Thank you, Mr. Yale.

3 MR. CARROLL: Your Honor, I meant to
4 signal, but I may have not done it effectively.

5 JUDGE CLIFTON: I'm sorry, I didn't see.
6 I'm sorry. Would you please go before Mr. Tosi,
7 Mr. Carroll, if you're ready now? Mr. Carroll,
8 you may go now.

9 MR. CARROLL: All right.

10 CROSS-EXAMINATION

11 BY MR. CARROLL:

12 Q. How many employees at your plant? Do you
13 have an approximate size?

14 A. The plant -- out of the total employees,
15 the plant is about 75.

16 Q. And how many employees overall are there
17 in the farm?

18 A. Overall, there are 345.

19 Q. And directing your attention to the
20 impact of the total loss of exemption, what impact, if
21 any, would that have on your business?

22 A. As I indicated to Mr. Beshore, we believe
23 that becoming a fully regulated pool plant would
24 increase our costs by millions of dollars a year.

25 Q. Other than increasing your costs, would

1 it cause you to have to make any changes in service or
2 quality of product?

3 A. You know, I think that candidly it's
4 difficult to know what exactly would make sense in that
5 world, and you know -- but it -- I believe that the
6 structure that would make the most -- that would make
7 the most sense for us then would be very different than
8 what we look like right now.

9 Q. Do you have any idea what that structure
10 would look like?

11 A. Not yet.

12 Q. I take it you're in hopes you don't have
13 to reach that point?

14 A. Yes, I am in hopes that we -- we don't go
15 there.

16 Q. I want to direct your attention now to
17 the last page of your statement at page 8. You make the
18 statement: Aurora believes that any national policy
19 that is adopted should preserve options, not foreclose
20 them. Some of the proposals, frankly, punish vertical
21 integration in any form other than a cooperative. This
22 is potentially -- quintessentially anticompetitive and
23 bad for consumers because it freezes the United States
24 marketplace. It picks one business model as the winner.
25 It stifles entrepreneurial enterprise, and it

1 eliminates independent vertically-integrated operations
2 that meet changing consumer depends.

3 Directing your attention to that
4 statement, why do you think that's bad for consumers?

5 A. I think that as a group, the
6 producer-handlers, while we're all a fairly independent
7 and disparate bunch, I think we are all serving very
8 different consumer niches. We are very consumer and
9 customer focused. And, you know, for us, the example is
10 private label organic milk.

11 Candidly, that's -- before we started
12 doing it, it wasn't really being offered even. And
13 there's proven to be demand for it. Now, other people
14 in the marketplace are offering it, too. And you know,
15 consumers have benefited.

16 Q. And one other question that's a little
17 bit off the point. You went to school at Middlebury?

18 A. I did.

19 Q. Are you familiar with my clients? I have
20 Monument Dairy, and I take it you must have had their
21 milk while you were in school?

22 A. Middlebury College has the best dairy
23 products in the dining hall, bar none. And I realize
24 that that's an unusual thing to say in this room where
25 there are so many who are proud of the Penn State or the

1 Cornells or the Wisconsins, but the products that
2 Monument Farms and other farms in Vermont supply to the
3 dining halls at Middlebury are remembered and loved by
4 all alums.

5 Q. And do you understand their testimony is
6 that they would be forced out of business if this
7 proposal was established? Would you support that
8 result?

9 A. No.

10 MR. CARROLL: That's all. Thank you.

11 JUDGE CLIFTON: Thank you, Mr. Carroll.

12 Mr. Tosi.

13 MR. TOSI: We have no questions, your
14 Honor. But we'd like to thank Ms. Keefe for
15 coming all the way from Colorado to testify here
16 and participate with us. Thank you.

17 THE WITNESS: You're welcome.

18 JUDGE CLIFTON: Redirect, Mr. Ricciardi?

19 REDIRECT EXAMINATION

20 BY MR. RICCIARDI:

21 Q. Al Ricciardi for AIDA. And I might note
22 that given the time from when we started and the time
23 we've come back together, I feel like I'm coming back to
24 talk to a long-lost friend, Ms. Keefe. So let me see if
25 I can wrap up a couple of points.

1 You were having a discussion, I believe
2 it was with Mr. Beshore, with regard to distinguishing
3 between the cooperative model and the producer-handler
4 model. And I don't think you got to explain the risks
5 and the burdens that are associated with operating under
6 the producer-handler model as much as you wanted to, so
7 I'm giving you that opportunity now.

8 A. Some people have suggested that an
9 individual handler pool is a little bit like a
10 producer-handler, which is a little bit like the way a
11 co-op might behave. And it's -- it is very difficult to
12 operate independently, to invest heavily in both the
13 farming side of the business as well as the processing
14 side of the business and through balancing make it all
15 work together to effectively serve the marketplace.

16 And I think that a producer-handler is
17 one way of being vertically integrated on a scale that's
18 a little bit smaller than some of the other models
19 within our industry.

20 Q. And with regard to that model that you
21 just started to describe, there are significant risks,
22 whether they be financial or otherwise, that the other
23 models don't have to bear?

24 A. That's correct. As a producer-handler,
25 you bear the full risk and responsibility for both the

1 farming -- for both your farming operations as well as
2 your processing operations, your marketing, your
3 distribution. You have to carry it from cow to carton
4 and then some.

5 Q. Okay. You were also -- I'm going to go
6 to another point.

7 You were also asked some questions, I
8 believe by Mr. English, about whether or not Aurora is
9 actually required to make payments into the pool as a
10 partially regulated plant or not in Arizona for sales
11 there. There were comparisons raised between that
12 partial regulation and what would occur if, in fact, the
13 producer-handler model was eliminated coming out of this
14 hearing. Can you explain the differences in magnitude
15 to Aurora's business?

16 A. Given our volume of sales in Arizona, our
17 obligations as a partially regulated distributing plant,
18 there are on the order of a few thousand dollars a
19 month. And, you know, they don't -- they total -- it's
20 not even -- it's not even a six-figure number for a
21 year. And whereas what we're talking about here is the
22 national elimination of producer-handler status. And so
23 that is something that any cost for a business like ours
24 with thin margins, that is, millions of dollars a year,
25 is something that you need to think very hard about.

1 Q. And on that point, if Aurora is required
2 to be fully regulated and pay into the pool to everyone
3 in that particular order, did the people who are going
4 to get that money actually invest or take the risk with
5 Aurora when Aurora was making the decision to become a
6 producer-handler?

7 A. No, they didn't invest or take the risk
8 with us when we were making the decision to become a
9 producer-handler. They didn't take the risk to
10 transition to organic even. The -- the simple fact of
11 the matter is, is that there's an extraordinarily
12 limited supply of organic milk where I am.

13 In Colorado, in addition to -- to my
14 three organic dairy farms, there are two others. In
15 Texas, there are a handful of organic dairy farms.
16 We're talking about a very specialty milk supply that --
17 that we have a system here that's putting -- putting the
18 square peg in the round hole. It doesn't work very well
19 from my perspective.

20 Q. I'm going to ask you another -- another
21 point. I think there were some questions that were
22 raised by Mr. Yale with regard to the processing that
23 Aurora uses for the organic product --

24 A. Uh-huh.

25 Q. -- the UHT. Is that the current standard

1 within the industry?

2 A. Within the organic industry, UHT is very
3 much the norm and the customers prefer it. We designed
4 our plant with the capabilities to do either, and have
5 frankly been surprised at how low the demand has been
6 for the high temperature short time, HTST, organic milk.

7 Q. You indicated that it was customer or
8 consumer demand. Is that the standard that the
9 customers want? Is that why Aurora uses it?

10 A. Yes, we use it because it's the standard
11 that the customers want. Within private label, it's
12 very common for the customers to -- to require that you
13 meet the national brand equivalent. In our case the
14 national brand equivalents are ultra pasteurized.

15 Q. And then I have a general question.
16 During the course of many of the questions that were
17 raised to you, you raised concerns about inquiry into
18 Aurora's confidential or proprietary information. Is
19 that the policy of Aurora, not to provide or disclose
20 that information?

21 A. Yes. It's our policy not to provide or
22 disclose that information. We're a privately-held
23 company. We do fully comply with the reporting
24 requirements for the orders. And, you know, not the
25 farm production stuff that Mr. Beshore was so interested

1 in, but, you know, a lot of the information about who
2 we're selling to and the whats, wheres, and whys and all
3 of that is reported to the Central Order each and every
4 month.

5 Q. That type of information is reported to
6 the MA's office at the USDA and is then held as
7 confidential under their particular policies, right?

8 A. Yes, it is.

9 Q. Okay. Last area. One of the proponents
10 of Proposals 1 and 2, which declined actually to even
11 agree to Proposal Number 26, is IDFA?

12 A. That's correct.

13 Q. Now, I'm surprised by this, but isn't
14 Aurora an IDFA member?

15 A. Yes, we are.

16 Q. And did they consult you before they
17 decided that they were going to try to take a regulatory
18 position that might detrimentally affect your business
19 as a member?

20 A. No, they did not.

21 Q. And what's your position on that?

22 A. I was very disappointed.

23 Q. Are you currently disappointed?

24 A. I remain disappointed.

25 MR. RICCIARDI: Thanks.

1 JUDGE CLIFTON: Ms. Keefe, your testimony
2 here is extremely important. You're uniquely
3 positioned, from what I've heard in almost two
4 weeks of testimony. And I thank you very much
5 for appearing.

6 THE WITNESS: You're welcome.

7 JUDGE CLIFTON: All right. Ms. Keefe may
8 step down. And, Mr. Ricciardi, what would you
9 like to do next?

10 MR. RICCIARDI: Get a couple hours'
11 sleep, Judge. Your Honor, we can proceed, if
12 you would like. The next witnesses are going to
13 be the dairy economists. We can either go
14 forward with that at this point, or we might
15 want to end up taking a lunch break at this
16 moment before we start them, so they won't be
17 interrupted.

18 JUDGE CLIFTON: All right. I'm going to
19 ask by a show of hands how many would like to
20 start our lunch break now. If your answer is
21 yes, raise your hand that you would like lunch
22 now. And if your answer is no, you'd like to
23 get into the testimony of it first, raise your
24 hand.

25 You know, if Messrs. Beshore and English

1 are ready to get into the testimony -- they're
2 the ones that just got the statements today --
3 then I think we should have a little testimony.

4 MR. BESHORE: We could have the direct
5 perhaps.

6 JUDGE CLIFTON: Okay. Good. We won't go
7 too long. I don't want anybody to faint during
8 this testimony. Mr. Ricciardi.

9 MR. RICCIARDI: At a minimum, Judge, if
10 we're going to do this -- at a minimum, Judge,
11 if we are going to start, can we take a
12 six-minute break?

13 JUDGE CLIFTON: No, we need more.

14 MR. RICCIARDI: Okay. Ten? Okay.

15 JUDGE CLIFTON: Yeah. Please be back and
16 ready to go at 12:30. That gives you eleven
17 minutes.

18 (A recess was taken from 12:24 to 12:37.)

19 JUDGE CLIFTON: We're back on record at
20 12:37. While we were off record Mr. English
21 made a suggestion. I'm going to ask that he
22 repeat it.

23 MR. ENGLISH: Thank you, your Honor. And
24 during the break I tried to get agreement. I
25 don't think I did, but my suggestion was that

1 the vast majority want to go to lunch and we're
2 for the -- I, for my part, do not wish to stand
3 in the way of that. I raised my hand because
4 you asked me what my opinion was.

5 The real concern here -- two different
6 concerns. One is that Dr. Yonkers, who has been
7 here since the first day, needs to leave by noon
8 tomorrow. And I think that it's one thing for a
9 witness to be here a couple days. It's another
10 thing to be here a couple of weeks. To ask him
11 to keep being kept off, I think, is a problem
12 and ultimately inappropriate. And he really
13 does have to leave by noon tomorrow.

14 Second, while the rules of practice are
15 clear that the beginning of the morning you get
16 statements of proponents and that was complied
17 with, we clearly have had statements this
18 morning for two economic experts. They are very
19 significant, lengthy, you know. Whether they
20 are meat or not will depend on what happens
21 next. But there are certainly some substantial
22 materials there to be discussed.

23 Dr. Cryan and Dr. Yonkers put their
24 statements out last Monday and everybody had an
25 opportunity to pursue them at great length,

1 before either witness went on the stand,
2 certainly before cross-examination.

3 And therefore, we really think in
4 fairness to Dr. Yonkers, we need to get him,
5 really, done today. I had some discussion with
6 counsel. I was hoping to get agreement. We
7 didn't quite get agreement.

8 I believe that the view of -- of -- and I
9 want them to speak for themselves -- but counsel
10 who are sponsoring the economic experts
11 otherwise is that Dr. Yonkers can get done
12 tomorrow. We don't know that. We don't know
13 how much -- how much questions the government
14 may have. We don't know whether there will be
15 redirect of Dr. Yonkers, and to make that gamble
16 that he go tomorrow when he has been here two
17 weeks, I think is -- is unfortunate and not
18 right.

19 My suggestion is that we take the lunch
20 break, we take the direct of Dr. Knutson and
21 Dr. Knoblauch and then we have the
22 cross-examination of Dr. Yonkers. That would
23 give those of us who really need some time to
24 think about and focus on the testimony of
25 Dr. Knutson -- Dr. Knutson and Dr. Knoblauch an

1 opportunity to be very focused, we hope, in our
2 cross-examination; at least more focused. And I
3 think it's also fair to Dr. Yonkers.

4 JUDGE CLIFTON: Before I hear from
5 anybody else, let me say that I had been
6 planning, since I can remember, maybe even since
7 the first day -- I don't recall -- that today
8 would be the day for these two experts,
9 Dr. Knoblauch and Dr. Knutson.

10 Now, it was my understanding this is
11 their only day here. Let me first confirm
12 whether that is true. Mr. Ricciardi.

13 MR. RICCIARDI: Your Honor, I believe,
14 although I would need to talk to Dr. Knoblauch
15 on this, that they could be available tomorrow.
16 I know that they cannot be available on Monday.
17 So I need to get confirmation on that point that
18 you've asked me.

19 JUDGE CLIFTON: Okay. Would you find
20 that out, so that we know that so that that's in
21 the mix? And let me ask Mr. English a question
22 Mr. English, if you're going to use the
23 cross-examination time of Dr. Yonkers today to
24 make sure it's in, why would we not do that next
25 before we begin Drs. Knutson and Knoblauch?

1 MR. ENGLISH: Well, two things, your
2 Honor. First, I was trying to also accommodate
3 the other side a little bit here. And second,
4 hearing the testimony from the -- from the
5 witnesses and also making sure we get the whole
6 direct. Because there's been additional direct,
7 which we don't know but we assume there may be,
8 would allow us then the time to -- in between,
9 to focus that.

10 So it was two things, your Honor. It was
11 simply an opportunity to try to move the ball
12 forward, get their direct in, make sure that's
13 done but also to make sure that it's their
14 entire direct. And it would help us focus our
15 attention on what that is, in order to prepare
16 for the cross.

17 JUDGE CLIFTON: Okay. All right. Let me
18 hear first from Mr. Ricciardi.

19 MR. RICCIARDI: Your Honor, I have been
20 told that both Drs. Knoblauch and Knutson could
21 be tomorrow although their flight schedule's in
22 the afternoon, I believe, for both of them.
23 Would you like to hear my thoughts as to how we
24 proceed?

25 JUDGE CLIFTON: Yes, please.

1 MR. RICCIARDI: Thank you. I do think
2 taking some time for lunch does make sense. So
3 there's one point of agreement we do have. And
4 your Honor is correct, we have scheduled the
5 economists that are going to be presented by
6 AIDA for a period of time. With regard to
7 Dr. Yonkers and the carryover, that had
8 absolutely nothing to do with us and trying to
9 make that arrangement. It's just the way it's
10 happened.

11 The way that makes the most sense is for
12 us to actually have the lunch break -- hopefully
13 it's not shrinking as I talk -- then have the
14 presentation of the direct, followed by the
15 cross of Drs. Knutson and Knoblauch so that we
16 don't have an attenuated process when we don't
17 have to have one.

18 And then I will represent to you that I
19 have gone around to those people who are
20 crossing in the room. I haven't talked to the
21 government table. And we will make the
22 representation that if, in fact, we start with
23 Dr. Yonkers at 8:00, that he will be out of here
24 by noon, period.

25 JUDGE CLIFTON: Okay. Mr. Carroll.

1 MR. CARROLL: I don't know if this is
2 separate and if so, we can put this to another
3 time. But this -- I'm talking now of
4 Dr. Knutson's statement, which they were kind
5 enough to give us today. It's about 35 or 36
6 pages.

7 We've been here a long time. All of us
8 have got this. I think whatever you are going
9 to do with -- this is very technical economic
10 data, mainly, statements and rationales. It
11 isn't the sort of thing I would hear him on the
12 stand and get anything out of except that I read
13 this.

14 And I'm wondering if we couldn't all, in
15 this witness's case, wave two hours or three
16 hours of time while he laboriously reads what we
17 all have anyway, and as long as everyone has a
18 reasonable chance for cross-examination to keep
19 this thing moving.

20 JUDGE CLIFTON: If he wants to read his
21 statement into the record, I will permit him, as
22 I have every other witness. Mr. Vetne.

23 MR. VETNE: Yeah, just briefly. I think
24 we ought to break for lunch. I think it's
25 important to have continuity of witness direct

1 statements and cross-examination. I just didn't
2 want this record to reflect something that I
3 think is unfair, the fact that Dr. Yonkers has
4 been here for a week and a half is somehow less
5 fair to him.

6 Please remember that IDFA is a
7 co-proponent. Proponents have the burden of
8 proof. That's his job. The rest of us are just
9 responding. I think that he is being
10 disaccommodated, I think, is an unfair
11 characterization.

12 JUDGE CLIFTON: I think Dr. -- I think
13 Dr. Yonkers' plan to be here through noon on
14 Friday was made before we failed to complete his
15 testimony. I mean, we meant to get him in a
16 long time ago and each day we meant to add him
17 in if we could. And we've passed over and
18 passed over and passed over him. But I think he
19 had already planned to be here through noon on
20 Friday regardless of when we heard his
21 testimony. Am I correct on that?

22 DR. YONKERS: That's correct.

23 MR. ENGLISH: That is correct, your
24 Honor. He is here through noon tomorrow.

25 JUDGE CLIFTON: Okay.

1 MR. ENGLISH: But --

2 JUDGE CLIFTON: Now, to me, if I'm a
3 witness and I've been able to get my direct into
4 evidence, I'm happy. And if the opposition to
5 my position is willing to limit their
6 cross-examination to when I have to leave at
7 noon on Friday, I'm even happier.

8 But I can understand that what counsel
9 want is to put Dr. Yonkers in to give you a
10 little more time to digest what's in Exhibit 89
11 and 90, and I certainly understand that.
12 Mr. English.

13 (Exhibit 89 was marked for
14 identification.)

15 (Exhibit 90 was marked for
16 identification.)

17 MR. ENGLISH: Your Honor, I repeat that
18 counsel for the other side may commit that
19 they'll done by noon tomorrow, leaving us no
20 time to do any redirect, if there is any, and
21 leaving no questions from the government,
22 conceivably. That's just not right. And the
23 idea that somehow you know every witness who's
24 come -- we hoped that Dr. Schiek would be on
25 Monday. He had to wait an extra day. The idea

1 that a witness can only go one day when actually
2 we've just been told these two witnesses can be
3 here tomorrow if necessary --

4 Leaving aside who's the proponents,
5 Dr. Yonkers has been available multiple days.
6 And for whatever reason -- and, you know, I can
7 repeat my point that I think that
8 cross-examination has been unfettered, and as a
9 result this hearing has gone on very long.

10 Dr. Yonkers hasn't gone on. That's not
11 his fault. And we need to get him on the stand.
12 And a commitment that we start tomorrow morning
13 and he's done at noon tomorrow leaves the very
14 real possibility we'll get to noon tomorrow and
15 then we're the losers.

16 A commitment he can be done by noon
17 tomorrow is simply not sufficient given how long
18 cross-examination has gone in some witnesses.
19 And I just -- I have to insist that he get on
20 today. It's just -- you don't get to parachute
21 in and get out.

22 JUDGE CLIFTON: I've been thinking about
23 having him at least by noon tomorrow. Now you
24 have thrown another constraint in here.

25 MR. ENGLISH: Yeah, he'll been done by

1 noon tomorrow as long as he starts today. But
2 if he starts at 8:00 a.m. tomorrow, he might not
3 be done. That's the constraint.

4 MR. BESHORE: Very quickly. I withdraw
5 my vote to not have lunch now.

6 JUDGE CLIFTON: Okay.

7 MR. BESHORE: Beyond that, you know, I
8 fully support the proposed order that
9 Mr. English has proffered. And I would just
10 make this note. There are two principal
11 economists in support of proponents, Dr. Cryan
12 and Dr. Yonkers.

13 Dr. Cryan, there was a week between his
14 direct and his cross. And there's been however
15 many days -- I don't even want to count them
16 right now -- between Dr. Yonkers' testimony
17 being available and cross. Okay?

18 Now, we're being the -- there are two
19 principal economists on the other side. We're
20 now being asked by the other side to have their
21 statements this morning, have them on the stand
22 and have immediate cross-examination. That's
23 palpably unfair and we shouldn't proceed that
24 way. We should have at least Dr. Yonkers worked
25 in, as Mr. English has proposed.

1 JUDGE CLIFTON: Mr. Ricciardi and then
2 Mr. Miltner, and then we'll go to lunch. But
3 I'll tell you who the first witness is going to
4 be. Go ahead, Mr. Ricciardi.

5 MR. RICCIARDI: Well, if you've made that
6 decision, Judge, I won't add anything more.
7 Let's go to lunch unless you need more
8 information from me.

9 JUDGE CLIFTON: Okay.

10 MR. RICCIARDI: Because I am going to
11 tell you right now -- again, I represent to
12 you -- and I've gone around the room for those
13 who are principal examiners -- we get him on at
14 8:00, he's out of here by noon.

15 JUDGE CLIFTON: Okay. Mr. Miltner, did
16 you want to add anything else?

17 MR. MILTNER: Only that Dr. Knutson just
18 reminded me his availability next week is none,
19 so we do need -- that is critical.

20 JUDGE CLIFTON: Okay. All right. We'll
21 take an hour for lunch. Then we'll begin
22 Dr. Knutson's direct and cross and see how long
23 it's taking us. But we will not stop with
24 Dr. Knutson's direct. We'll do direct, and then
25 we'll begin cross. And then I'll reserve

1 judgment on what happens after that.

2 MR. MILTNER: Your Honor, they're going
3 to be on a panel.

4 JUDGE CLIFTON: Oh, they're going to go
5 together.

6 MR. MILTNER: Yes.

7 JUDGE CLIFTON: Oh. Well, we may --

8 MR. ENGLISH: And, your Honor, that's the
9 problem.

10 MR. STEVENS: Your Honor. Your Honor.
11 Are we off the record or --

12 JUDGE CLIFTON: No, you're on.

13 MR. STEVENS: Garrett Stephen, Office of
14 the General Counsel. I think now we're down to
15 an issue of fairness, and I think everyone in
16 this room that has been here has seen what has
17 transpired. To have the economists go up after
18 lunch and then have them cross-examined
19 immediately after that, I can't see the fairness
20 to that position relative to the other
21 economy -- economists.

22 JUDGE CLIFTON: All right.

23 MR. STEVENS: There has been a long
24 period of time between their testimony.

25 JUDGE CLIFTON: So you think every

1 economist should be evaluated for a while before
2 cross begins?

3 MR. STEVENS: Well, certainly more than
4 just the time of their testimony, given the
5 history of this proceeding. I hear the
6 arguments of counsel, but the basic fairness
7 issue is something I don't think you can really
8 dispute. One -- one -- one set have testified
9 and now cross-examination is delayed.

10 JUDGE CLIFTON: Okay.

11 MR. STEVENS: And this group that we're
12 going with now, the cross-examination will occur
13 right after their testimony. I just can't see
14 those as being two equal opportunities. So I
15 just note that for the record, your Honor.

16 JUDGE CLIFTON: Okay. Now, if my
17 objective is to distance cross-examination from
18 direct, we should have direct before we break
19 for lunch.

20 MR. ENGLISH: It's 1:00. It's going to
21 be an hour and a half.

22 JUDGE CLIFTON: No one likes that idea.
23 No one likes that idea. All right. So your
24 assertion that my schedule is unfair,
25 Mr. Stevens, does not relate to my beginning the

1 direct examination of Dr. Knutson and
2 Dr. Knoblauch; it is based on when I begin their
3 cross?

4 MR. STEVENS: Yes, yes.

5 JUDGE CLIFTON: All right. I certainly
6 don't want to be unfair to USDA, who is
7 represented here by Mr. Stevens. I am here,
8 after all, on behalf of the Secretary.

9 So we'll take an hour for lunch. Then
10 we'll have the direct testimony of Drs. Knutson
11 and Dr. Knoblauch. Then we'll have the
12 cross-examination of Dr. Yonkers, and then we'll
13 begin the cross-examination of Drs. Knutson and
14 Dr. Knoblauch. We'll try to finish it all
15 today.

16 All right. Please be back and ready to
17 go at -- it's almost 1:00 -- at 2:00.

18 (A recess was taken from 12:54 to 2:04.)

19 JUDGE CLIFTON: All right. We're back on
20 record at 2:04. I'd like to correct something
21 that I said right before lunch. In my
22 crankiness, I said we would try to finish the
23 three experts today. I will be delighted if we
24 finish them today. But I do not mean by that
25 that I'm going to push you till 9:00 tonight.

1 I don't think that would be wise. So if
2 we get close to 6:00 and cannot reasonably
3 finish whoever we're working on, we won't. I
4 will not work you to death, nor will I work the
5 court reporters to death.

6 When I said it, I would have. But upon
7 reflection, I will not. And then the other
8 issue is, I am aware how meaty these statements
9 are and how much they need evaluation. And so I
10 will not rush you through that.

11 All right. Mr. Miltner, shall I have the
12 witnesses come forward?

13 MR. MILTNER: That would be great, your
14 Honor.

15 JUDGE CLIFTON: All right.
16 Drs. Knoblauch and Knutson -- Knoblauch and
17 Knutson, would you please take the witness
18 stand?

19 MR. MILTNER: I'll let them fight over
20 who gets the cushy chair.

21 DR. KNOBLAUCH: I am deferring to my
22 elder.

23 MR. MILTNER: For the record, that was
24 Dr. Knoblauch.

25 JUDGE CLIFTON: Now, if you want to pour

1 water before you start, that's fine. If you're
2 comfortable for now, that's also fine. All
3 right.

4 Well, you have seen the rituals on how
5 close you must be to the microphone. So you
6 really will need to move it physically back and
7 forth in order to talk right into it. I'd like
8 first Dr. Knutson to state and spell his name.

9 DR. KNUTSON: Yes. I'm Ronald Knutson
10 that's R-o-n-a-l-d, K-n-u-t-s-o-n. And it is
11 pronounced Knutson.

12 JUDGE CLIFTON: And, Dr. Knutson, what
13 type of doctorate do you hold?

14 DR. KNUTSON: I hold a Ph.D. in
15 agricultural economics from the University of
16 Minnesota.

17 JUDGE CLIFTON: Thank you. And now,
18 please, Dr. Knoblauch.

19 DR. KNOBLAUCH: Wayne Knoblauch. The
20 spelling of my last name is K-n-o-b-l-a-u-c-h.

21 JUDGE CLIFTON: All right. And I've been
22 trying to pronounce it phonetically. But I see
23 now it's Knoblauch.

24 DR. KNOBLAUCH: That's correct.

25 JUDGE CLIFTON: Very good. And what type

1 of doctorate do you hold?

2 DR. KNOBLAUCH: A Ph.D. in agricultural
3 economics from Michigan State University.

4 JUDGE CLIFTON: I'll swear you in
5 together.

6 (The witnesses were sworn.)

7 JUDGE CLIFTON: Each witness has
8 answered, I do. Mr. Miltner you may proceed.

9 W. ANTHONY BOSTWICK
10 of lawful age, being duly sworn, was examined and
11 testified as follows:

12 DIRECT EXAMINATION

13 BY MR. MILTNER:

14 MR. MILTNER: Thank you, your Honor. I
15 would like to start with Dr. Knoblauch. We have
16 on the record your Ph.D., but could you give us
17 just a brief professional and academic history
18 for the record?

19 DR. KNOBLAUCH: I have a bachelor of
20 science degree from Michigan State University in
21 agricultural economics, a master of science
22 degree in agricultural economics also from
23 Michigan State University. I joined the faculty
24 of Cornell University in 1976 and have worked my
25 way through the ranks.

1 I am now a professor in what is now
2 called the department of applied economics and
3 management but is physically in the same
4 location doing many of the same tasks we did
5 when we were the department of agricultural
6 economics.

7 MR. MILTNER: And you've had the title of
8 full professor since 1989, is that right?

9 DR. KNOBLAUCH: Yes, that's correct.

10 MR. MILTNER: And what is your primary
11 area of expertise within agricultural economics?

12 DR. KNOBLAUCH: My specialty is in dairy
13 farm management, business analysis, cost of
14 production studies, almost anything relating to
15 the operation and management of a dairy farm.

16 MR. MILTNER: And in your research and
17 your academic work at Cornell do you also work
18 with other professors on other projects dealing
19 with the dairy industry?

20 DR. KNOBLAUCH: Yes, I do. I also teach
21 classes, conduct extension work with farmers in
22 New York and the Northeast.

23 MR. MILTNER: Have you had a chance to
24 testify at a Federal Order hearing before?

25 DR. KNOBLAUCH: No.

1 MR. MILTNER: Have you had a chance to
2 testify in any other types of proceedings
3 before?

4 DR. KNOBLAUCH: I believe there was one
5 state milk order hearing, but the other
6 testimony has been in litigation.

7 MR. MILTNER: And rough numbers, how many
8 cases do you believe you provided your -- your
9 economic analysis for?

10 DR. KNOBLAUCH: Limited to deposition or
11 trial testimony or --

12 MR. MILTNER: Yeah, let's start with
13 deposition or trial testimony.

14 DR. KNOBLAUCH: Probably approaching a
15 hundred cases.

16 MR. MILTNER: How about as a consultant
17 outside of providing testimony?

18 DR. KNOBLAUCH: Probably 300 situations.

19 MR. MILTNER: Thank you. And if you
20 could hand the microphone over to Dr. Knutson.

21 Dr. Knutson, I have the same series of
22 questions for you. In addition to your
23 doctorate degree that we have on the record, can
24 you provide us a little bit of background for
25 you academically and professionally?

1 DR. KNUTSON: Yes, I received my
2 bachelor's degree from the University of
3 Minnesota in 1961 or '62. And I received my
4 master's degree from Pennsylvania State
5 University a year later. And then I received my
6 Ph.D. from the University of Minnesota in 1967.
7 I went to Purdue University and was a faculty
8 member there for four years.

9 I then went to the U.S. Department of
10 Agriculture in a staff economist position in the
11 agricultural marketing service of USDA. And
12 then I went to a politically appointed position
13 as the head of Farmer Cooperative Service in
14 USDA.

15 In 1975, I went to Texas A&M University.
16 I worked there in the area of dairy policy. I
17 later become the -- became the director and
18 founder of the Agriculture and Food Policy
19 Center at Texas A&M University, which exists
20 today, headed up by one of my former students.

21 The mission of the Agriculture and Food
22 Policy Center is to do analyses for the Congress
23 on the impacts of changes in farm policy.

24 Oh, I guess I should say that I am now a
25 professor emeritus from Texas A&M. I retired a

1 few years ago, and I continue to work in the
2 department of agricultural economics on a
3 part-time basis on special projects.

4 MR. MILTNER: Okay. And what is your
5 area of expertise within agricultural economics?

6 DR. KNUTSON: Well, as I said, initially
7 started out at Purdue University in dairy area,
8 direct marketing working on the development of
9 regional cooperatives. I then continued at
10 Texas A&M, but worked more generally in the area
11 of agricultural policy based on my experience in
12 the U.S. Department of Agriculture.

13 So I would have to say that during the
14 bulk of my lifetime it's -- my professional life
15 has been spent on a combination of dairy
16 economics and agricultural policy.

17 MR. MILTNER: And you've had the
18 opportunity to testify at Federal Milk Marketing
19 Order hearings in the past?

20 DR. KNUTSON: I have. I've probably
21 testified in -- oh, probably four different
22 hearings, maybe five.

23 MR. MILTNER: And in addition to Milk
24 Marketing Order hearings, have you had the
25 opportunity to provide your analysis and

1 opinions in -- in other cases? And we'll start
2 with trials and depositions, as we did with
3 Dr. Knoblauch.

4 DR. KNUTSON: Yes, I -- probably not as
5 many as he has. I've testified and given
6 depositions in probably 15 different instances,
7 probably two-thirds of them being in the dairy
8 area.

9 MR. MILTNER: Have you had the
10 opportunity to provide your consulting services
11 and expertise in other proceedings?

12 DR. KNUTSON: Yes, I certainly have, an
13 extensive number of proceedings over the years
14 to a wide variety of interests in dairy and
15 outside of dairy.

16 MR. MILTNER: Your Honor, we have copies
17 of the CVs for both Drs. Knutson and Knoblauch.
18 They are available on the front table here. I
19 believe at least one of the statements refers to
20 it as an attachment. They're extensive and
21 lengthy, and so we haven't attached them. But
22 anybody that cares to review one of the CVs is
23 certainly welcome to do so.

24 I think I advised most of the attorneys
25 representing other parties that they've been

1 available. And so they're at the front table,
2 so -- I don't know if we want to -- in this type
3 of proceeding we don't need to offer them as
4 experts. Their testimony and their backgrounds
5 are what they are but however the Court wants to
6 proceed, we'll welcome -- we defer to the Court.

7 JUDGE CLIFTON: Is there anyone -- well,
8 first of all, let me ask, do you, Mr. Miltner,
9 want those CVs to be exhibits and on the
10 website?

11 MR. MILTNER: I don't believe that's
12 necessary, your Honor.

13 JUDGE CLIFTON: All right. Is there
14 anyone who has anything to say about whether I
15 should accept Dr. Knutson and Dr. Knoblauch as
16 experts in the field of agricultural economics?

17 No one has a comment on that. I think
18 you're clearly experts in the field of
19 agricultural economics. And I accept each of
20 you as such.

21 MR. MILTNER: And, your Honor, we've
22 marked -- the Court has marked -- the judge has
23 marked Dr. Knutson's statement as Exhibit 89, is
24 that correct?

25 JUDGE CLIFTON: That's correct.

1 MR. MILTNER: And Dr. Knoblauch's as
2 number 90?

3 JUDGE CLIFTON: Correct.

4 MR. MILTNER: Okay. We'd actually like
5 to present Dr. Knoblauch's first. And before
6 we -- we begin that, I want to just briefly have
7 you comment on the scope of your opinions and
8 testimony. So, Dr. Knoblauch, if you could take
9 the mic.

10 Given your area of expertise, just in a
11 sentence or two, what's the focus of your
12 statement here?

13 DR. KNOBLAUCH: The focus of my statement
14 would be on cost --

15 JUDGE CLIFTON: That needs to be higher.
16 You're so tall.

17 DR. KNOBLAUCH: Sorry.

18 JUDGE CLIFTON: If you'll --

19 DR. KNOBLAUCH: I think that's as high as
20 it goes.

21 JUDGE CLIFTON: You need to pull it very
22 close to you and point it up. Yes. I think
23 that will work right there.

24 DR. KNOBLAUCH: Okay. The purpose of my
25 testimony and the topics covered in my testimony

1 relate to the cost of producing milk, cost of
2 processing milk based on studies that have been
3 conducted in our department at Cornell
4 University.

5 MR. MILTNER: Okay. And if you could
6 slide the mic over to Dr. Knutson just once
7 more.

8 And, Dr. Knutson, given your background
9 and area of expertise, what's the focus of your
10 testimony?

11 DR. KNUTSON: My -- the focus of my
12 testimony is on Federal Milk Marketing Order
13 policy and the factors influencing Federal Milk
14 Marketing Order policy on dairy marketing and
15 cooperative marketing.

16 MR. MILTNER: And so, fair to say that,
17 Dr. Knutson, your testimony, your area of
18 expertise relates more directly to -- to the
19 nuances of Milk Marketing Federal Order
20 regulation and dairy policy?

21 DR. KNUTSON: It does, yes.

22 MR. MILTNER: And Dr. Knoblauch, your
23 testimony, in accordance with your area of
24 expertise, relates more directly to costs and
25 efficiencies for both farms and plants, is that

1 correct?

2 DR. KNOBLAUCH: That's correct.

3 MR. MILTNER: Okay. So I guess we can go
4 right into Dr. Knoblauch's statement then, your
5 Honor.

6 DR. KNOBLAUCH: I will be reading into
7 the record the document, Exhibit Number 90,
8 entitled testimony of Dr. Wayne A. Knoblauch On
9 Behalf of American Independent Dairy Alliance
10 (AIDA).

11 The first section, Introduction and
12 Qualifications. I am here today to present
13 testimony at this hearing on behalf of the
14 American Independent Dairy Alliance (AIDA). I
15 am a Professor in the Department of Applied
16 Economics and Management in the College of
17 Agriculture and Life Science at Cornell
18 University. I earned a Ph.D. in agricultural
19 economics from Michigan State University in
20 1976. I have been on the faculty at Cornell
21 University since that time. At Cornell
22 University, I teach and conduct research and
23 extension programs in dairy farm management. I
24 have won numerous awards for my research,
25 teaching, and extension programs. My curriculum

1 vitae is attached to this testimony.

2 My testimony for AIDA in this hearing
3 addresses three principal areas. First, drawing
4 upon Cornell University research and USDA-ERS
5 statistics, it discusses the costs of producing
6 milk by both large and small dairy farmers.
7 Second, I discuss the prices for milk actually
8 received by dairy farmers basing my discussion
9 on the continuing research done at Cornell
10 concerning mailbox milk price. Third, my
11 testimony addresses the research done at Cornell
12 University to study the costs actually incurred
13 by value-added processors, including some
14 producer-handlers and the costs actually
15 incurred by regulated fluid milk bottlers.
16 Finally, I briefly discuss the costs of
17 balancing incurred by producer-handlers.

18 Costs of Milk Production. For more than
19 50 years, Cornell has conducted surveys of New
20 York dairy farmers on a wide range of topics,
21 including the cost of producing milk.

22 Footnote 1, See the References and
23 Citations Section at the end of my testimony for
24 a listing of Cornell University Dairy Farm
25 Business Summary publications that I relied on

1 in preparing my testimony.

2 Data from the Dairy Farm Business Summary
3 and Analysis program for 2006, 2007 and 2008 was
4 analyzed by herd size. The Dairy Farm Business
5 Summary represents the average of above average
6 producers. For example, the producers in the
7 study are above average in terms of milk
8 production per cow and financial performance.

9 Not surprisingly, the results show that
10 each -- I'm sorry, that in each of the most
11 recent three years, as herd size increases,
12 total cost of producing milk decreases. Small
13 herds, those with less than 100 cows, averaged a
14 total cost of \$23.16 per hundredweight in 2008.
15 For herds with greater than 800 cows, the total
16 cost of producing milk decreased to \$18.15 per
17 hundredweight. The difference between small and
18 large herd sizes is in 2008 of \$5.01 can be
19 attributed to improved rates of production per
20 cow, and capital and labor efficiencies. Yet,
21 despite these efficiencies, and of particular
22 relevance to this hearing, it is important to
23 note that the cost of production exceeds the
24 uniform price for small herds in all years but
25 not for large farms in good milk price years,

1 notably 2007 and 2008. While 2009 data is not
2 available, it can be expected that for all herd
3 sizes, the costs of production will by far
4 exceed the uniform price.

5 The USDA, Economic Research Service cost
6 of milk production data represents the costs for
7 the average producer. Thus, their data shows
8 costs that are higher per hundredweight of milk
9 produced than the Dairy Farm Business Summary.
10 The ERS average data demonstrates that even when
11 measured against the Class I price, the cost of
12 production exceeds the Class I price by 5 to 8
13 dollars per hundredweight. See the attached
14 graph for actual Dairy Farm Business Summary and
15 ERS cost of production data in comparison to
16 milk prices.

17 The Cornell data and other data from
18 other studies, most notably the United States
19 Department of Agriculture, Economic Research
20 Service studies, show that scale economies
21 virtually disappear after 1,250 cow herd size is
22 attained. This is regardless of geographic
23 region of the United States. See especially
24 USDA, ERS Publication Number 47, September 2007.
25 But nevertheless, even for those producers with

1 these larger, more efficient herds, their cost
2 of production regularly exceeds the uniform
3 prices and even the Class I prices of the
4 orders. Given this fact, dairy farmers,
5 regardless of the size of their herd, cannot
6 rely on simply marketing their raw milk to
7 ensure long-term economic viability of their
8 farm operations.

9 Milk price differences. The case that
10 Federal Milk Marketing Orders provides uniform
11 milk prices for all producers is just plain
12 wrong. Cornell University compiles period
13 reports and surveys of producer paychecks, which
14 are sorted and analyzed to provide a clearer
15 picture of producer returns. These reports
16 demonstrate that even within the structure of
17 Federal Orders, farms will be paid differently
18 based on component levels shipped in Multiple
19 Component Pricing orders, somatic cell counts in
20 these orders where that is accounted for, and
21 the Producer Price Differential. As you can see
22 from the attached milk check data, over-order
23 premiums and deductions from milk checks differ
24 significantly across farms. See Comparing Your
25 Milk Checks, Stephenson.

1 In any year, there is about a \$2.00
2 difference from high to low within New York
3 state alone based on components, and this is not
4 taking colored breeds with higher milk
5 components out of the equation.

6 JUDGE CLIFTON: Let me ask you there.
7 You said that is not taking them out and the
8 statement says, and this is taking them out.

9 DR. KNOBLAUCH: If I said that, I
10 apologize. It is. And this is taking breeds
11 with higher milk components out of the equation.
12 They were removed.

13 JUDGE CLIFTON: All right.

14 DR. KNOBLAUCH: So if I included not, I
15 misspoke.

16 JUDGE CLIFTON: All right. Just read
17 that sentence again for us, please.

18 DR. KNOBLAUCH: In any year, there is
19 about a \$2.00 difference from high to low within
20 New York state alone based on components, and
21 this is taking colored breeds with higher milk
22 components out of the equation. There is also a
23 \$2.00 spread in what we call the Net Marketing
24 Margin, which takes the Producer Price
25 Differential plus all premiums minus all

1 expenses (including hauling). The net marketing
2 margin is a good measure of actual differences
3 among similarly situated farms because a farm
4 could always get a higher Producer Price
5 Differential by shipping their milk to Boston in
6 Order 1 or to Miami in Order 6, for that matter.
7 However, the hauling costs could more than
8 offset the higher Producer Price Differential.
9 Taking these marketing decisions into account,
10 along with components of producer milk, this
11 research data makes the point that producers do
12 not receive equal payments under the current
13 Federal Order system.

14 What would producers gain by having
15 producer-handlers pooled? In 2008, about
16 39 percent of the producer receipts in Federal
17 orders were used in Class I sales. The
18 producer-handler roll in 2008 was about
19 1.5 percent of Class I sales. If we assume that
20 the average Class I differential that would have
21 been paid by producer-handlers was between \$2
22 and \$3 per hundredweight, then the average
23 statistical uniform price would have increased
24 from \$18.24 per hundredweight to 18.25 to
25 \$18.26, a mere 1 to 2 cents per hundredweight.

1 These increases in the uniform prices due to the
2 full regulation of producer-handlers would
3 neither offset the differences already existing
4 among producer mailbox prices nor would it
5 change the existing spread among producers.
6 Producers are not losing significant revenues
7 because producer-handlers are not contributing
8 to the pool. Just to put this in perspective,
9 this is well below the 4 to 5 cents of
10 administrative costs required in most Federal
11 orders that producers would have to pay.

12 Let's talk about the pay price to the
13 producer. The cooperative set the prices to the
14 extent that they are above minimum price, and
15 also have add-on charges and deductions which
16 they charge back to the producers. Thus, the 1
17 to 2 cents might never even go into producers'
18 pockets in any event.

19 Value-added processors. My Cornell
20 University colleagues, Chuck Nicholson and Mark
21 Stephenson, conducted a study of producers who
22 operated plants to determine the viability and
23 profitability of their operations. In this
24 study, (RB 206-07) Nicholson and Stephenson
25 refer to the business as Value-Added processors

1 rather than Producer-Handlers, because there are
2 several farms which are bottling and selling
3 fluid milk but also many farms making
4 manufactured products. We decided to conduct a
5 study of these operations in New York, Vermont,
6 and Wisconsin in 2006. There were 27 operations
7 in total that were studied. Some of them were
8 goat or sheep farms, but most were traditional
9 dairy farms. Some bottled and sold fluid milk
10 but most made cheese or other manufactured
11 products. Still, there were six operations
12 bottling cow's milk which had producer-handler
13 status involved in the study.

14 Enterprise accounting was used to
15 separate the income and expense of producing
16 milk from processing and marketing of finished
17 products. When processing net income (which
18 includes the cost of the milk produced) was
19 plotted against total processing receipts, a
20 distinct pattern was observed. The report shows
21 a regression line through these data points
22 which indicates that regardless of product
23 produced or type of milk (cow, sheep or goat) a
24 value-added processor needed to receive about
25 \$100 per hundredweight in total returns in order

1 to break even.

2 Fluid milk processors in this study were
3 found to average \$2.38 in process costs (not
4 including milk price) per gallon. There was
5 only one farm in the study that made a modest
6 return on both milk production and processing.
7 Most made a bit -- let me start again, please.
8 Most made a bit of profit in one side of their
9 operation or the other. If part of the
10 rationale for a Producer-Handler exemption is to
11 allow them some room to compete with larger
12 specialized fluid plants, it is obvious from
13 this study that that need still exists.

14 The additional burden of contributing
15 equalization payments to the pool and the
16 associated paperwork would certainly put some
17 folks out of business. And, this really comes
18 without the usual Class I benefit of performance
19 (balancing) for most producer-handlers.

20 Cost of processing. Admittedly,
21 producer-handlers in the Value-Added study were
22 smaller sized operations. However, another
23 Cornell University study clearly shows that
24 larger plant size and higher plant capacity
25 utilization increased plant labor productivity.

1 Furthermore, both factors also directly impact
2 plant cost per gallon. The total effect of
3 operating a larger plant, considering both the
4 direct effect on cost per gallon and the
5 indirect effect on costs through increased labor
6 productivity, was substantial if plant size
7 changed significantly. See EV -- I'm sorry.
8 See RB 97-03, Erba, Aplin, and Stephenson.

9 For example, increasing from 2 million
10 gallons (17.24 million pounds) per month to
11 3 million gallons, (25.86 million pounds)
12 decreased plant cost per by 4.1 percent.
13 Increasing from 3 million gallons per month to
14 4 million gallons, 34 -- (34.48 million pounds)
15 per month further decreased plant cost per
16 gallon by 2.7 percent. Given their analysis was
17 based on costs exclusive of depreciation, the
18 cost advantage of larger plants when including
19 depreciation is undoubtedly even larger because
20 the investment per gallon is lower in larger
21 plants. This provides evidence that plants in
22 the 15 to 30 million pounds of milk per month
23 are still finding substantial returns to scale
24 and have not yet reached the flat portion of the
25 cost curve which occurs after the

1 30 million pounds of milk per month. The
2 assertion that fluid milk bottling plants reach
3 a level of efficiency at 3 million pounds of
4 Class I volumes each month sufficient to compete
5 on a level playing field with larger
6 regulatory -- regulated bottlers is simply
7 untrue. When we further consider that this
8 study was completed over 12 years ago and it is
9 likely that the scale economies have moved to
10 even larger volumes since then.

11 Producer-handlers, even those processing volumes
12 of milk at the upper ends of the levels
13 estimated by NMPF in its economic testimony are
14 simply not in the range of the scale to compete
15 with equal milk costs with large, fully
16 regulated plants.

17 Balancing costs. Producer-handlers must
18 balance their own milk supplies with demand for
19 their fluid products. If a producer-handler
20 produces more milk than it is able to sell as a
21 finished product, the disposal of surplus milk
22 is either through outlets that the
23 producer-handler might possess or sales to
24 another outlet at a negotiated price - usually
25 the lowest class price - not the statistical

1 uniform price. We tend to think of the uniform
2 price as the opportunity cost that a
3 producer-handler foregoes for the privilege of
4 selling at a higher Class I level, but that is
5 not the case for sales of milk to balance their
6 production. The significant cost of balancing
7 is placed on the producer-handlers. For
8 example, the U.S. average statistical uniform
9 price in 2008 was \$18.24 per hundredweight, but
10 the Class IV price only averaged \$14.65 that
11 year. The penalty to a Producer-Handler for
12 selling milk at the Class IV price was therefore
13 \$3.59 per hundredweight.

14 For example, if 20 percent of the
15 producer-handler's milk was sold to balance
16 demand, it is receiving a penalty of at least 72
17 cents per hundredweight of milk produced (3.59
18 times 0.20) versus operating as a plant with
19 100 percent Class I sales.

20 Conclusions. The results of Cornell
21 University research showed that each of the most
22 recent three years, as herd size increases,
23 total cost of producing milk decreases and
24 decreases significantly, but plateaus at
25 approximately 1,250 cows. This is consistent

1 with studies performed by others, most notably,
2 the USDA Economic Research Service. Taken in
3 tandem, the data from the DFBS and the ERS
4 demonstrate that the total costs of production
5 across all herd sizes exceeds the FMMO blend and
6 Class I prices.

7 Milk check research data clearly makes
8 the point that producers do not receive equal
9 payments under the current Federal Order system.
10 This is true even if one ignores the differences
11 in farm-to-farm component payments. Over-order
12 premiums and other marketing decisions result in
13 milk checks that vary substantially between
14 producers in the same Federal Order. If
15 producer equity is a goal of Federal Milk
16 Marketing Orders, then attacking -- I'm sorry,
17 then lack of attaining that goal has little to
18 do with the producer-handlers.

19 Value-added research simply -- I'm sorry.
20 Value-added research clearly implies that
21 producer-handler status is a small step in the
22 direction of leveling the playing field with
23 large specialized fluid plants.

24 As both farms and plants get larger,
25 producer-handler operations still function at a

1 comparative disadvantage to larger fully
2 regulated plants. Even the largest farms do not
3 generate consistent returns from simply
4 marketing raw milk to ensure profitability, and
5 assuming that those large farms elect to operate
6 producer-handling -- producer-handler bottling
7 plants, economies of scale from plant size are
8 not fully realized at the levels of volumes that
9 even the larger producer-handlers operate.

10 Producer-handlers can incur large costs
11 in balancing milk supplied to meet their own
12 customer demands. These costs are incurred by
13 the producer-handler and not by the pooled
14 producers in the order.

15 Then there is a References and Citations
16 section. Should that also be read?

17 MR. MILTNER: I don't know that reading
18 the references into the record is necessary
19 because they're listed on the exhibit, which
20 we'll move its admission at the appropriate
21 time, Judge.

22 Dr. Knoblauch, is there anything else
23 that you want to add at this time? I didn't
24 mean to stop you in your statement.

25 DR. KNOBLAUCH: No, I have read the --

1 read the statement.

2 MR. MILTNER: Okay. Very good. Now,
3 before we have Dr. Knutson read his statement --
4 and I'm not going to finish the direct exam
5 here, but I did want to point out that those
6 items listed under References and Citations,
7 Dr. Knoblauch, are most of those available
8 online at the Cornell University website, those
9 that are referred to as research bulletins and
10 the like?

11 DR. KNOBLAUCH: Those that are from
12 Cornell, yes.

13 MR. MILTNER: And the others are USDA
14 data references?

15 DR. KNOBLAUCH: Yes. And those are
16 available online.

17 MR. MILTNER: And, your Honor, as had
18 been done earlier in this hearing, copies of the
19 documents were set out on the front table. Many
20 of them have left, and I assume they're around
21 the room. But I believe there were at least
22 three copies of each of those documents for
23 people to review and they've been up there for
24 at least a good portion of the day.

25 And one thing I did want to point out.

1 One of the documents that was put out there and
2 made available was a document called Comparing
3 Your Milk Checks by Dr. Mark Stephenson, which
4 is referred to in the statement. On page 3 of
5 your testimony, Dr. Knoblauch, there's a line at
6 the end of the first paragraph that says, as you
7 can see from the attached milk check data,
8 over-order premiums and deductions from milk
9 checks differ significantly across farms.

10 Now, at the end of your statement is a
11 chart but that doesn't have the milk check data
12 on it, does it?

13 DR. KNOBLAUCH: No. No, it does not.
14 The milk check data is not stapled to my
15 statement. It should have been or currently is
16 on the front table.

17 MR. MILTNER: It was up there. But
18 that's -- what I'm holding up is a copy of
19 Comparing Your Milk Checks, is that right, and
20 it has the tables at the end?

21 DR. KNOBLAUCH: Yes.

22 MR. MILTNER: Okay. Because he's
23 referred to it in his statement, as being, see
24 from the attached data, I've made 30 copies of
25 that report only, and I'll be happy to

1 distribute them right now, your Honor.

2 JUDGE CLIFTON: Yes, let's mark that --
3 I'll let you distribute them in a moment, but
4 we'll call that Exhibit 91.

5 MR. MILTNER: That would be fine. Thank
6 you. And now let's go off record.

7 (Exhibit 91 was marked for
8 identification.)

9 (Off the record.)

10 JUDGE CLIFTON: We're back on record at
11 2:44. With regard to Exhibit 90, I would like
12 the last sentence stricken on the record copy.
13 And, Dr. Knoblauch, I would like you to initial
14 that before you leave the room. And the person
15 who keeps the record copy is seated at the
16 second table to our right on the far end. And
17 with regard to Exhibit 91, that has now been
18 distributed. Is there any objection to Exhibit
19 91 being admitted into evidence? There is none.
20 I hereby admit into evidence Exhibit 91. And
21 we'll deal with the Exhibit 90 and the Exhibit
22 89 wherever you want to, Mr. Miltner.

23 MR. MILTNER: That would be fine, Judge.
24 And just to be sure, I'm not sure what you said
25 but what I heard is we're striking the last

1 sentence in Exhibit 90. But I want to make sure
2 it's the last sentence in the first paragraph of
3 Exhibit 90.

4 JUDGE CLIFTON: That's correct. And it
5 reads: My curriculum vitae is attached to this
6 testimony.

7 MR. MILTNER: Okay. Thank you. And then
8 Dr. Knutson, if you would want to proceed with
9 your statement, please.

10 DR. KNUTSON: Thank you. Introduction
11 and qualifications. My name is Dr. Ronald D.
12 Knutson. I am a Professor Emeritus at Texas A&M
13 University and reside at 1011 Rose Circle in
14 College Station, Texas. At Texas A&M, I served
15 for 28 years as a professor and for 13 years as
16 Director of the Agricultural and Food Policy
17 Center, whose primary tasks involved completing
18 studies of the impacts of proposed policy
19 changes for the U.S. Congress. Prior to
20 accepting the Texas A&M position, I was the
21 Chief Economist in USDA's Agricultural Marketing
22 Service and the Administrator of its Farmer
23 Cooperative Service. Throughout my nearly 50
24 years as a professional agricultural economist,
25 one of my primary research areas has been dairy

1 marketing and policy. In this capacity, I
2 served as the Chairman of two USDA Milk Pricing
3 Advisory Committees; one evaluated the regional
4 cooperative developments in the late 1960s and
5 the early 1970s, Minnesota-Wisconsin
6 manufacturing milk pricing series, and the
7 implication for Federal Milk Marketing Order
8 pricing. The second USDA study evaluated
9 pricing and classification options for Federal
10 Milk Marketing Order Reform. And I would
11 propose striking the words on attachment my
12 professional resume, as well.

13 JUDGE CLIFTON: Let's do that right now.
14 The end of the first paragraph on Exhibit 89,
15 that sentence will be stricken. And Dr. Knutson
16 will initial that before he leaves. So what is
17 being stricken is: I have attached my
18 professional resume.

19 DR. KNUTSON: Preparation for testimony.
20 I have been engaged by the members of the
21 American Independent Dairy Alliance (AIDA) for
22 the purpose of analyzing the market position of
23 producer-handlers, to evaluate the petitions --
24 positions taken by the petitioners and their
25 impacts, and to evaluate the alternative

1 proposals presented in this hearing by AIDA
2 members. To accomplish this task, I have
3 reviewed and analyzed the -- analyzed the
4 National Milk Producers Federation (hereinafter
5 NMPF) and the International Dairy Foods
6 Association (hereinafter IDFA) petitions. I
7 have reviewed the Federal Register for this
8 hearing dated April 9, 2009, and the Federal
9 Register Final Decision dated December 14, 2005,
10 regarding the regulation for producer-handlers
11 for the Pacific Northwest and Arizona-Las Vegas
12 orders, hereinafter referred to as the 2006
13 producer-handler decision. I have reviewed and
14 analyzed much of the data and information
15 related to the hearing that has been posted by
16 the Dairy Programs/AMS/USDA, and relied on this
17 data for substantial portions of my analysis.
18 In addition, I have reviewed and analyzed AIDA's
19 Requests for Denial of Proposals to Eliminate
20 Producer-Handler Exemption and have analyzed and
21 evaluated IADA's alternative proposals.
22 Finally, I surveyed the members of IADA to
23 become familiar with their operations and to
24 obtain data that I could utilize in completing
25 my analysis and in developing my testimony.

1 JUDGE CLIFTON: And, Doctor, those
2 initials, again, for the American Independent
3 Dairy Alliance, would you again read those into
4 the record. You referenced to them just now
5 twice.

6 DR. KNUTSON: AIDA.

7 JUDGE CLIFTON: Thank you.

8 DR. KNUTSON: Summary of conclusions
9 reached. I have concluded that it is time for a
10 Federal Order policy reality check in the
11 context of today's milk industry and how it
12 operates. This reality check is particularly
13 important because this hearing decision is
14 establishing national policy for Federal Order
15 regulation and for the dairy industry. The NMPF
16 and IDFA proposal that is before you would, for
17 the first time I am aware of, effectively
18 eliminate an economic marketing option for milk
19 producers having over 250 cows. As a matter of
20 national dairy and Federal Order policy, such a
21 regulatory change would not only be inconsistent
22 with the Federal Order policy since its creation
23 under the Agricultural Marketing Agreement Acts
24 of 1937, as amended (the AMAA hereinafter); it
25 would be also be inconsistent with the American

1 economic free-enterprise system as established
2 by our forefathers.

3 From a national perspective, the
4 producer-handler organizational form, subject to
5 the regulatory limits that have been established
6 by USDA, is not and never has created disorderly
7 marketing conditions. It is not possible from a
8 macroeconomic national perspective, for
9 producer-handlers with only 1.46 percent of the
10 fluid market, to have sufficient market power to
11 become disorderly under any reasonable
12 definition of the term. On both the cooperative
13 and processor sides of the market, there are
14 large concentrations of market power that make
15 the producer-handlers' share minuscule by
16 comparison.

17 There is no realistic threat that
18 producer-handlers will ever achieve such a scale
19 of operation that they would become a source of
20 disorder within the meaning of the AMAA. If
21 Federal orders were giving producer-handlers the
22 substantial advantages that have been and are
23 being alleged, there would surely be a
24 substantial influx of new producer-handlers to
25 take advantage of these opportunities. There is

1 no such influx. In any case, and in the
2 interest of preserving competition and choice in
3 our economic system, the producer-handler status
4 is a valuable option for all producers based on
5 the economics of their operations.

6 The activities of producer-handlers do
7 not violate the purposes of the Federal orders
8 as specified in the AMAA. Surely, with only
9 39 percent of the milk supply being used in
10 Class I, consumers are assured of an adequate
11 supply of pure and wholesome milk. Surely,
12 cooperatives have effectively utilized the
13 variety of methods available to them for
14 addressing the farm income situation. It is
15 equally certain that the NMPF and IDFA proposals
16 do not and could not address the farm income
17 situation. The principal assertions relied upon
18 by the NMPF and IDFA to establish disorderly
19 marketing conditions on a national scale are not
20 substantiated by the data. The data presented
21 and cited herein clearly first while --
22 indicate; First, while Federal Orders set
23 minimum prices, in most instances these minimum
24 prices do not exist in the marketplace, and
25 little milk or no milk is traded at these

1 minimum prices. The Federal Order minimum
2 prices are masked in the market by premiums,
3 charged by cooperatives, that frequently exceed
4 the minimum price by \$2.00 per hundredweight or
5 23 cents per gallon. While Market
6 Administrators calculate a blend price, few
7 producers receive that price even after taking
8 into account variation in the values of milk
9 components. In fact, it is not unusual for
10 producers who are members of cooperatives to
11 receive less than the blend price, for producer
12 pay prices to vary substantially among producers
13 within the same cooperative. Any disorder that
14 may exist in Federal Order markets is far more
15 likely to be caused by the fact that raw milk
16 prices have little or no relation to Federal
17 Order prices than it is to be caused by the
18 unsupported assertion that producer-handlers
19 create disorder that adversely affects price and
20 income objectives of the AMAA.

21 In this environment, dominated by the
22 NMPF cooperative members, it is asserted that
23 the appropriate transfer price is the difference
24 between the Federal Order blend price, which
25 does not exist in the market, and the Federal

1 Order Class I price, which also does not exist
2 in the market. This reasoning defies economic
3 logic not only because these Federal Order
4 prices are not market prices but also because in
5 the real world, transfer prices are based on
6 costs.

7 Any decision to change national
8 producer-handler policy presents different
9 issues than those previously considered by US --
10 the USDA. A national policy decision requires
11 an analysis of the entire milk market and the
12 role of producer-handlers in that market. My
13 analysis clearly and factually indicates:
14 First, producer-handlers are frequently
15 producing unique and growing niche market
16 products -- products such as organic, kosher,
17 and grass-fed milk, which inherently is much
18 more costly to produce. Second, some
19 producer-handlers continue the tradition of
20 delivering milk to consumers. Third,
21 producer-handlers are forced to adjust their
22 production patterns to minimize surplus
23 production, which would be sold at a substantial
24 loss. Fourth, the managers of producer-handler
25 options have to divide their attention between

1 both the farming and the processing sides of the
2 operation, which reduces the cost advantages
3 that would otherwise be associated with
4 specialization.

5 JUDGE CLIFTON: Doctor, please reread
6 that fourth item.

7 DR. KNUTSON: Fourth. The managers of
8 producer-handler operations have to divide their
9 attention between both farming and the
10 processing sides of the operation, which reduces
11 the cost advantages that otherwise would be
12 associated with specialization. Fifth,
13 producer-handlers have substantial sunk capital
14 investment costs in their production,
15 processing, and distribution. Ignoring these
16 realities leads to conclusions about
17 producer-handlers that are without foundation.

18 In the 1962 Nourse Report to the
19 Secretary of Agriculture -- excuse me, the 1962
20 Nourse Report to the Secretary of Agriculture
21 took great care in defining the orderly
22 marketing objective of Federal Orders. Its
23 definition describes the characteristics of
24 orderly markets in economic terms, including
25 equalizing the market power of the buyers and

1 sellers, assuring adequate and dependable milk
2 supplies, maintaining economic order in the
3 industry, ensuring equitable treatment of all
4 parties and maximum freedom of trade with proper
5 protection against loss of outlets. The
6 emphasis here is on maintaining a regulatory
7 balance among all parties in the marketplace and
8 treating all parties equitably, and by
9 implication, not necessarily equally. Certainly
10 the Nourse Report concept of orderliness would
11 not support a national policy that put minority
12 independent producer-processor interests at a
13 competitive disadvantage or deny producers the
14 option of becoming fluid milk processors.

15 Proposals 23, 24 and 25 are alternatives
16 to the elimination of the producer-handler
17 designation that are workable, consistent with
18 other Federal Order regulations, and will not
19 have the effect of damaging existing businesses,
20 or unreasonably restricting future choice.
21 These options include exempting all
22 producer-handler's own-farm production with
23 down-allocation, exempting all producer-handler
24 milk sold through home delivery and
25 handler-controlled retail outlets, and by

1 establishing individual handler pools for all
2 handlers across all Federal orders.

3 The remaining segments of my testimony
4 presents facts that will substantiate the
5 conclusion that producer-handlers are not a
6 source of disorder in milk markets and will
7 discuss the implications of current rulemaking
8 process -- of the current rulemaking process for
9 Federal Order policy. I will then explain and
10 analyze how IDA -- AIDA proposals would address
11 the issues that gave rise to this hearing.

12 JUDGE CLIFTON: Let's do those initials
13 one more time.

14 DR. KNUTSON: IADA.

15 JUDGE CLIFTON: You really want it to
16 start with an I?

17 DR. KNUTSON: Excuse me, AIDA. I'm
18 sorry.

19 JUDGE FELSON: Thank you.

20 DR. KNUTSON: There's too many initials.
21 Overall status of producer-handlers in the milk
22 industry. In the context of a consolidated
23 national dairy industry where multi-state
24 cooperatives and national processors and
25 retailers exert significant market control,

1 producer-handlers are small, both in their
2 relative size and in the aggregate. By
3 regulatory requirement, they are operations that
4 control all of their milk production facilities
5 and all of their milk processing facilities.
6 Certainly, the size of producer-handlers and the
7 producer -- and -- excuse me.

8 Certainly, the size of producers,
9 handlers, and producer-handlers has grown over
10 the years. Table 1 provides a factual
11 comparison of these growth trends. It was
12 developed from data that are contained in the
13 record. However, in the absence of complete
14 records, for the years 1969 to 1992 the
15 producer-handler volume data were estimated by
16 multiplying the Class I Federal Order sales
17 times the monthly percent of sales by
18 producer-handlers as posted by Dairy Programs in
19 preparation for this hearing. This sales
20 estimate was then divided by the number of
21 producer-handlers from the same Dairy Programs
22 source.

23 The data in Table 1 indicate that the
24 average producer size increased by 4.3-fold from
25 1969 to 2001 and 5.7-fold from 1969 to 2008.

1 The average handler size increased by nearly
2 9.2-fold from 1969 to 2001, by nearly 10.3-fold
3 to 2006, and then, with reduced sales, decreased
4 to 9.3-fold in 2008. The average
5 producer-handler increased by 4.5-fold over the
6 1969 to 2001 period, by nearly 8.3-fold to 2005,
7 and then decreased to 6.1-fold in 2008. As
8 would be expected, because producer-handlers are
9 both milk producers and processors, the average
10 producer-handler increase in size lies between
11 that of the producer size increase and the
12 processor size increase.

13 These data clearly indicate that
14 producer-handler growth is constrained, which is
15 not what the NMPF and IDFA would like USDA to
16 believe. The fact that producer-handlers must
17 maintain sole ownership and control over their
18 operations places a de facto limit on the size
19 of producer-handlers that is dictated by the
20 realities of their integrated operations. This
21 fact is forever -- corroborated by the posted
22 table titled, Federal Order Small Plant
23 Structure Information for May 2008 that was
24 appended to and relied upon by the NF -- NMPF
25 petition for this hearing. Table 2 abstracts

1 from this table to clearly indicate that
2 producer-handlers and other exempt plants have
3 been greatly constrained in growth relative to
4 conventional regulated pool distributing plants.
5 Of the 45 producer-handlers in May 2008, 40 have
6 a sales volume of less than 2 million pounds,
7 and only 5 had a volume of over
8 2 million pounds. All -- all of the exempt
9 plants had a volume of less than
10 2 million pounds. No producer-handlers even
11 approach the increasingly common
12 30 million-pound size that characterizes the
13 cutting edge of today's fluid milk processing
14 sector. The over 30 million size category is
15 not broken out in the May 2008 table.

16 In sharp contrast, only 46 conventional
17 pool distributing plants had a volume of less
18 than 2 million pounds. And I have a correction
19 here. Strike 507 and insert 210. And another
20 insert in the next line, strike 507 plants and
21 insert 201.

22 So let me read it from the start as it
23 should be. In sharp contrast, with only 46
24 conventional pool distributing plants that had a
25 volume of less than 2 million pounds and 210

1 that had a volume of over 2 million pounds. Of
2 these 210 plants, 73 had a volume of over
3 20 million pounds. While it can be presumed
4 that more volume and less competition are
5 preferred by the ownership of these 73 plants,
6 it is difficult to imagine the producer-handlers
7 having sufficient market power to create
8 disorderly market conditions. Excluding
9 competitors surely is not a role that Federal
10 Orders should either sanction or support.

11 If, as the NMPF and IDFA suggest,
12 producer-handlers are benefiting so much from
13 the producer-handler exemption, it is not
14 apparent in their numbers, which have declined
15 by 53 percent since 2001, from 79 to 37
16 producer-handlers in March 2009.

17 Figure 1 and the following Federal Order
18 statistics indicate the number of
19 producer-handlers for selected years:
20 October 1969, 421; October 1992, 137;
21 December 2001, 79 and a 42 percent decrease from
22 1992 in nine years, which is 4.6 percent
23 annually; December 2005, 46; December 2006, 43,
24 December 2008, 47, and a 41 percent decrease
25 from 2001 in seven years, which is 5.8 percent

1 annually; March 2009, 37 and a 21 percent
2 decrease in three months.

3 These data indicate that the number of
4 producer-handlers has declined successively
5 since 1960 from 421 to 37 in March 2009. It is
6 also informative to note that the rate of
7 decrease in producer-handler numbers has
8 accelerated from 4.6 annually from 1991 to 2001
9 to 5.8 percent annually from 2001 to 2008. Then
10 in three months from December 2008 to
11 March 2009, the number of producer-handlers
12 decreased by 21 percent. This rapid and
13 substantial decline indicates that a large
14 number of producer-handlers closed their doors,
15 given the adverse economic climate for milk
16 production and the lack of sufficient
17 producer-handler margins in processing and
18 distribution to absorb the losses in production.

19 As a consequence of the 2006
20 producer-handler Federal Order decision and
21 proposals by the NMPF and IDFA for this hearing,
22 it appears that eliminating producer-handlers
23 has become a principal national Federal Order
24 dairy policy objective of these petitioners.
25 Also, it is important to note that the Dairy

1 Program has not published, annually, a complete
2 set of statistics on the number and sales of
3 producer-handlers, apparently because
4 producer-handlers were not considered to be
5 sufficiently important in the markets for milk.

6 While the NMPF and IDFA might admit to
7 the fact that the number of producer-handlers
8 has decreased, they imply that producer-handler
9 sales have increased. This is not apparent from
10 the data, as illustrated in Figure 2 utilizing
11 the Dairy Programs statistics. The estimated
12 producer-handle sales volume suggests that
13 producer-handler -- suggests that
14 producer-handler sales volume hit a peak of
15 853 million pounds in 1992. Since 1992, the
16 producer-handler sales volume has declined.
17 Since 2000, which -- for which the Dairy Program
18 has posted annual producer-handler volume data,
19 producer-handler' sales volume has seen no
20 increasing trend. While it might be asserted
21 that since the Pacific Northwest, Arizona, Las
22 Vegas Federal Order decision, the
23 producer-handler volume may have rebounded, that
24 assertion would be based on only one year of
25 data. The indicated decline in the number of

1 producer-handlers in 2009 would suggest a
2 potential reversal of the increased volumes in
3 2008.

4 The percent sales by producer-handlers
5 shows the same declining trend. It is true that
6 producer-handlers' sales -- share of sales
7 surged in 2006. There was another surge --

8 JUDGE CLIFTON: Now, let me ask you.
9 What number do you want there at the end of that
10 sentence, the sentence that starts: It is true?

11 DR. KNUTSON: It is true that
12 producer-handlers share of sales surged in the
13 1960s. There was another surge from 1.6 percent
14 of route sales in 1980 to 1.9 percent in 1992.
15 However, by 2008 the producer-handlers' share
16 had declined to 1.46 percent. If the
17 producer-handlers' exemption was and is of such
18 great benefit, why is it that their market share
19 has not increased?

20 I have surveyed each of the
21 producer-handler members of the AIDA group.
22 While the AIDA members are highly diverse, and I
23 will say more about their factual
24 characteristics subsequently, there are seven
25 substantive statistics that stand out: First,

1 relative to cooperatives and processors that the
2 NMPF and IDFA represent, they are all small
3 businesses that run processing plants and market
4 the milk they produce.

5 Second, they each have their own market
6 niches that reflect ever-increasing diversity of
7 the consumer market, which no longer treats milk
8 as a homogenous commodity. In performing this
9 important function of appealing to consumer
10 diversity, they build and expand the market for
11 milk, compete more effectively with nondairy
12 products, and serve particular consumer tastes
13 and preferences, such as for organic products.

14 Third, those producer-handlers that home
15 deliver are often the last vestige of home
16 delivery service to customers who need this
17 higher level of service, and can afford to pay
18 for it. With an ever-increase -- ever-aging
19 population, this niche market service can become
20 more important in the future.

21 Fourth, they sometimes operate their own
22 stores, a further complex step in marketing
23 beyond producing and processing milk.

24 Fifth, emphasis in marketing to wholesale
25 outlets is often on smaller accounts and

1 certainly is in smaller volumes per account.
2 This emphasis is sometimes dictated by the
3 reality of supermarket retailers who limit shelf
4 space allocated to other than their conventional
5 major homogenous milk brands.

6 Their consumer price -- six, excuse me.
7 Their consumer prices generally far exceed those
8 of conventional products as dictated by higher
9 production costs for niche markets, higher
10 processing costs, higher distribution costs, and
11 by the pricing practices of the retail chains.

12 Seven, the minority of producer-handlers
13 that are tagged as being price competitors by
14 their rivals are viewed as -- are viewed as
15 such, because they are penetrating highly
16 concentrated monopolistic markets. In this
17 case, competition is welcomed by both the
18 wholesale and consumer customer base. Most
19 certainly this is not the type of competition
20 that Federal Orders were designed to regulate as
21 a matter of national policy. Quite the
22 opposite, Federal Orders were created at a time
23 when milk markets were highly monopolistically
24 controlled by a few major proprietary milk
25 processing firms. Competition is one of the key

1 factors that gets the public a sufficient supply
2 of milk at a reasonable price, a key objective
3 of the AMAA.

4 Assertion versus Reality: Who sets the
5 raw milk price? It is often asserted that
6 Federal Orders set raw milk prices. The NMPF --
7 excuse me, the NMPF petition makes this
8 assertion when it states on page 4 that the
9 regulated competitors of producer-handlers pay,
10 in quotes, the -- pay the Class I price for the
11 same milk, unquote, as producer-handlers
12 produce. In reality, the price paid by the
13 regulated competitors of producer-handlers is
14 not the Federal Order Class I price. Instead it
15 is generally the Class I price plus a
16 substantial premium that is set by large
17 cooperatives. The Dairy Programs/AMS/USDA refer
18 to this price as the announced cooperative Class
19 I price, which -- which it regularly reports in
20 its Dairy Market News weekly reports and
21 annually in its Dairy Market Statistics
22 publications. Premiums exist because
23 cooperatives have sufficient control over the
24 milk supply that they are able to demand and
25 extract premiums from even the largest milk

1 processors.

2 Table 3 indicates that cooperative
3 premiums over Federal Order Class prices
4 increased from an average of \$1.11 per
5 hundredweight in 1999 to \$1.83 per hundredweight
6 in 2006, then declined to \$1.81 per
7 hundredweight in 2007, and then increased to
8 \$2.48 per hundredweight in 2008. Clearly, the
9 trend in Class I premiums is in an upward
10 direction, and the trend more than just reflects
11 higher energy/transportation costs.

12 JUDGE CLIFTON: Before you go on to the
13 next point, that point, and it's labeled as
14 paragraph 24 on page 11, is entirely about
15 Class I prices and no other price, is that
16 correct?

17 DR. KNUTSON: Exactly.

18 JUDGE CLIFTON: Okay.

19 DR. KNUTSON: Table 4 indicates that for
20 the flush production month of April, the size of
21 the premium is highly variable from city to city
22 and over time. For example, in April of 2009,
23 Federal Order premiums ranged from 50 cents per
24 hundredweight in Phoenix to \$3.14 per
25 hundredweight in Chicago. Premiums are lower in

1 western markets largely because of competitive
2 factors associated with California regulation
3 and production. In the rest of the United
4 States, where Federal Orders and cooperatives
5 dominate -- excuse me -- the April 2009 premiums
6 for plants located in the cities indicated
7 ranged from \$1.50 per hundredweight in Boston to
8 \$3.14 per hundredweight in Chicago.

9 The data in Table 4 also indicates a
10 clear trend toward higher premiums for each of
11 the cities. Surprisingly, in April 2009, for a
12 number of markets such as Chicago, Dallas,
13 Denver, Kansas City, Oklahoma City, and Seattle,
14 cooperatives were able to increase premiums in
15 despite of surplus conditions, falling milk
16 prices, and falling energy prices. To an
17 economist this is a clear indication of
18 substantial cooperative market power. It is
19 also an indication that Federal Order markets
20 are not disorderly or chaotic in terms of milk
21 suppliers' ability to negotiate an advantageous
22 price. If producer-handlers were a significant
23 force causing market disorder, these premiums
24 would either be unstable or would not have
25 increased in 2009, or would not exist. The data

1 indicate that cooperative premiums do exist;
2 that these premiums are stable and that they
3 increased in 2009 in spite of surplus
4 conditions.

5 In addition to premiums, often fluid milk
6 processors are being forced to pay cooperatives
7 huge give-up charges in order to have access to
8 milk supplies used in their Class I bottling
9 operations. While give-up charges are not
10 publicly reported, professor Bob Cropp at the
11 University of Wisconsin writes that when milk
12 supplies are tight, give-up charges as high as
13 \$5.00 per hundredweight or more have been
14 experienced to get milk released by fluid use --
15 for fluid use by manufacturers. Economists
16 believe that a contributing factor to the
17 Chicago higher premiums, indicated in Tables 4
18 and 5, reflects the influence of give-up charges
19 by manufacturing plants located in the Upper
20 Midwest Federal Order. The Table 5 data for
21 2008 -- for October 2008, indicating a premium
22 of \$3.48 per hundredweight compared with \$2.80
23 per hundredweight in April 2008 substantiate
24 this point. Ultimately, the cost of these
25 give-up charges is borne by consumers. In

1 addition, huge premiums and give-up charges
2 suggest that they are not being well-served by
3 current Federal Order marketwide pooling
4 arrangements. The option of individual handler
5 pool -- pooling would substantially reduce the
6 incentives for give-up charges and premiums. In
7 other words, it would result in Class I prices
8 that exist to more closely approximate Federal
9 Order Class I prices.

10 The fact that Federal Orders do not set
11 the price that producers pay for milk --

12 JUDGE CLIFTON: Excuse me. Read that
13 sentence again.

14 DR. KNUTSON: The fact that Federal
15 Orders do not set the price that processors pay
16 for milk, indicates that price instability and
17 competitiveness factors in milk markets are
18 dominated by contesting between dominant
19 cooperatives and processors, not by the
20 insignificant market shares held by
21 producer-handlers who, as a general rule, are
22 not in a position to compete on the basis of
23 price. In addition, the very existence of
24 premiums and give-up charges build in extra
25 costs on processors for milk, distorts the price

1 surface set by Federal Orders, and enhances
2 consumer resistance to paying high prices for
3 conventional homogenous and undifferentiated
4 milk products. As a matter of national policy,
5 it would be incongruous to discriminate against
6 producer-handlers by forcing them to pay the
7 difference between the uniform Federal Order
8 blend price and the Class I price, while
9 ignoring the destabilizing effects and -- the
10 stabilizing effects and consumer price-enhancing
11 effects of cooperative premiums.

12 JUDGE CLIFTON: Let me interrupt you
13 there, Dr. Knutson. You are on page 13 and
14 you're about to begin a new section. And
15 because this is so concentrated, I'd like us to
16 take a 10-minute break right now.

17 DR. KNUTSON: That would be fantastic.

18 JUDGE CLIFTON: It's almost 3:30. Please
19 be back and ready to go at 3:40.

20 (A recess was taken from 3:29 to 3:41.)

21 JUDGE CLIFTON: All right. Let's go back
22 on record. All right. We're back on record at
23 3:43. Returning to page 13 of Exhibit 89, we
24 had completed paragraph 28. Dr. Knutson, you
25 may resume.

1 DR. KNUTSON: Assertion versus reality:
2 Who sets the producer blend price?

3 It is often asserted or implied that the
4 Federal Order blend price is the same as the
5 price paid to producers. In this hearing, this
6 is the basis for the petitioner's assertion on
7 page 4 of its petition that the blend price
8 is -- quote, is the appropriate transfer price
9 for analysis of the regulatory impact on the
10 producer-handler plant, unquote. The blend
11 price then becomes the justification for the
12 hearing proposal to require producer-handlers to
13 pay the difference between the Federal Order
14 Class I price and the Federal Order blend price
15 into the pool. While it is true that Federal
16 Order administrators calculate a Federal Order
17 blend price, this Federal Order blend price is
18 not the price that is actually paid to most
19 producers. Most producers are members of
20 cooperatives who blend and even reblend their
21 receipts across Federal Order markets to the
22 point that the prices paid producers have little
23 or not resemblance of the blend price calculated
24 by the Market Administrator for a particular
25 Federal Order market.

1 Let's talk real producer blend prices as
2 they are received by producers and appear in
3 Federal Order markets. The studies of mailbox
4 prices paid producers indicate that there is
5 wide variation in the prices paid to farmers,
6 even among producers located in close proximity
7 to one another. As explained by Professor
8 Knoblauch, the longest running and best known of
9 these Comparing Your Milk Checks studies has
10 been conducted and published by Cornell
11 University's Dairy Markets and Policy project
12 since 2001. From these studies, I computed the
13 differences in actual pay price -- price per
14 hundredweight between the lowest 10 percent and
15 the highest 10 percent of the participating New
16 York producers for the months as indicated in
17 Table 6 and Figure 4.

18 It is readily apparent that there is wide
19 variation in the prices received by producers.
20 For example, in September 2008, the highest
21 10 percent of the participating New York
22 producers received a net price for their milk of
23 \$19.67 per hundredweight while the lowest
24 10 percent received \$17.41 per hundredweight, a
25 difference of \$2.26 per hundredweight. Table 6

1 indicates from August 2001 to September 2008,
2 this price difference ranged from \$2.21 per
3 hundredweight to \$2.86 per hundredweight and
4 averaged \$2.57 per hundredweight. These data
5 clearly indicate there is substantial variation
6 in the price producers received for milk. More
7 detailed analysis of these data indicates that
8 while 65 percent of this variation can be
9 explained by component values and the producer
10 price differential, 35 percent is due to other
11 factors with which the -- of which the largest
12 57 cents per hundredweight is a residual term
13 referred to as the premium market value.

14 Also included in Table 6 is the Northeast
15 Federal Order blend price as computed and
16 reported by the Market Administrator. While the
17 blend price falls between the price received by
18 the lowest and highest 10 percent of the
19 producers, the data clearly indicate wide
20 variation in the net producer price around the
21 blend price.

22 What is the implication of this finding
23 for the outcome of this hearing? The NMPF
24 asserts that, quote, as the market price for
25 producer -- for producer milk on the market,

1 this (the uniform blend price) is the
2 appropriate transfer price for analysis of the
3 regulatory impact on the producer-handler plant,
4 unquote. The IDFA likewise asserts, quote, the
5 regulated price actually received by farmers is
6 the uniform or blend price, unquote. If the
7 uniform blend price is not actually received by
8 farmers, how can it be the appropriate transfer
9 price? Based on these false assertions, the
10 NMPF and the IDFA conclude that
11 producer-handlers should pay into the pool the
12 difference between the uniform blend price and
13 the Class I price. The NMPF's and IDFA's
14 assertion is false because the uniform blend
15 price clearly is not the market price and is not
16 actually received by farmers. The fact is that
17 there is a very wide range of market prices
18 received by producers.

19 The only real and appropriate transfer
20 price is the producer-handler's cost of
21 producing milk, which, as we have seen from the
22 testimony of Professor Knoblauch and verified by
23 my AIDA member survey, is substantially higher
24 than the uniform blend price calculated by the
25 Federal Order Market Administrators.

1 Assertion versus Reality: Are
2 producer-handlers a disorderly marketing force?

3 Deciding whether there is disorderly
4 marketing requires an analysis of the economics
5 of the marketplace for milk. In fact, defining
6 what disorderly marketing is not, is as
7 important and illuminating as what it is:

8 Disorderly marketing is not the same as
9 marketing. Marketing is delivering the right
10 product, in the right form, in the right place,
11 at the right time, and at the right price. Just
12 because producer-handlers are marketing milk
13 products does not mean they are disorderly.

14 Disorderly marketing is not the same as
15 niche marketing. Niche marketing is delivering
16 the right product, in the right form, in the
17 right place, at the right time, and at the right
18 price where the product, form, or place is
19 unconventional and limited in scope. Just
20 because producer-handlers are niche marketing
21 milk products does not mean that they are
22 disorderly. This is the case because niche
23 marketing firms, such as the AIDA members,
24 generally sell their products at prices that are
25 substantially higher than that of conventional

1 homogenous milk.

2 Disorderly marketing is not the same as
3 private labeling. If it were, then many of the
4 IDFA members would be engaged in disorderly
5 marketing. The fact that a producer-handler
6 private labels organic milk does not mean that
7 it is engaged in disorderly marketing. Rather
8 it is niche marketing within the private label
9 category.

10 Disorderly marketing is not the same as
11 being competitive. Being competitive involves
12 being able to sell products you produce and yet
13 be profitable. Being competitive without
14 government intervention characterizes American
15 capitalism, which we are now in serious danger
16 of losing.

17 Now turning to what is disorderly
18 marketing: At the time that the AMAA was
19 enacted, the orderly marketing emphasis was,
20 quote, to establish and maintain an orderly flow
21 of products to markets...in the interest of
22 consumers and producers...to avoid unreasonable
23 fluctuations in supplies and prices, unquote.

24 In the 1930s producer marketing was
25 highly disorganized and lacked orderliness. The

1 1962 Nourse Report to the Secretary of
2 Agriculture, which in the past was often used
3 for guidance in Federal Order decisions,
4 described the situation as follows: Dairy
5 farmers attributed their difficulties primarily
6 to three factors: (a) they were dealing
7 individually as small producers of a highly
8 perishable product in a market generally
9 dominated by a few large buying units; (b) their
10 milk, even though it met minimum market
11 standards, varied considerably in quality, and
12 in quantity it was subject to wide seasonal
13 variations; these condition -- (c) these
14 conditions made them vulnerable to severe price
15 cuts by dealers at flush seasons (or even
16 partial or temporary losses of market outlet),
17 and enabled dealers to reap most of the profit
18 from supply shortages while the farmers had to
19 bear most of the penalties of market surpluses,
20 unquote.

21 While this -- excuse me. This is a very
22 different situation than exists today where our
23 cooperative -- where our milk markets are
24 dominated by a few very large cooperatives, who,
25 as we have seen, are able to extract premiums

1 from sometimes equally large processors, who
2 effectively control the allocation of shelf
3 space in supermarkets.

4 While the 1962 Nourse Report credited
5 Federal Orders with having restored orderly
6 marketing, it also recognized that, quote,
7 complete and perfect orderliness in the disposal
8 of fluid milk in all at that time 81 Federal
9 Order markets has not been achieved. That would
10 not be possible, or indeed desirable, in a
11 dynamic enterprise market, unquote. The Report
12 also recognized the changes that had occurred
13 and were occurring in the milk industry. In a
14 concluding section titled, quote, There Are
15 Still Elements -- Are There Still Elements of
16 Disorder, unquote, the Nourse Report states,
17 quote, another element of disorder in price and
18 production relationships results from the
19 negotiation of premiums above established Class
20 I prices in a number of markets. Such premiums
21 introduce an element of instability both within
22 the market area affected and in intermarket
23 price relationships.

24 The 1972 Report of the Milk Pricing
25 Advisory Committee, titled Milk Pricing Policy

1 and Procedures: Part I: The Milk Pricing
2 Problem to USDA's Assistant Secretary of
3 Agriculture in charge of the Federal Order
4 program, picked up on the concern expressed by
5 the Nourse Report that cooperative premiums and
6 reblending were not the only source of
7 disorderly marketing conditions but also made it
8 difficult for the Secretary to achieve the
9 objectives of the Agriculture Marketing
10 Agreement Act.

11 Let me read it again. The 1972 report of
12 the Milk Pricing Advisory Committee, titled,
13 Milk Pricing Policy and Procedures: Part I:
14 The Milk Pricing Problem to USDA's Assistant
15 Secretary of Agriculture in charge of Federal
16 Order programs, picked up on the concern
17 expressed by the Nourse Report that cooperative
18 premiums and reblending were not only a source
19 of disorderly marketing conditions but also made
20 it difficult for the Secretary to achieve the
21 objectives of agricultural -- of the Agriculture
22 Marketing Agreement Act. It concludes that,
23 quote, Reblending of returns under a number of
24 different orders can result in blend prices to
25 producers that differ materially from blend

1 prices established under the orders involved.
2 Thus the influence of the structure of prices
3 resulting from the Secretary's decisions may be
4 altered, making it more difficult to achieve the
5 objectives of the Act, unquote.

6 The 1962 Nourse Report to the Secretary
7 of Agriculture painstakingly defined the orderly
8 marketing objective of Federal Orders to include
9 economic terms such as equalizing the market
10 power of buyers and sellers, assuring adequate
11 and dependable milk supplies, maintaining
12 economic order in the industry, ensuring
13 equitable treatment of all parties and maximum
14 freedom of trade with proper protection against
15 the loss of outlets. The emphasis here on is on
16 maintaining a regulatory balance among all
17 parties in the marketplace and treating all
18 parties equitably, and by implication not
19 necessarily equally. Certainly the Nourse
20 Report concept of orderliness would not support
21 regulations that put minority independent
22 producer-handler interests at a competitive
23 disadvantage. The Milk Pricing Advisory
24 Committee expands on this point by stating that,
25 quote, orderliness implies protecting the rights

1 of producers to choose their market outlet, free
2 of coercion and unreasonable barriers to market
3 entry, unquote. Surely a producer-handler falls
4 within the definition of a producer.

5 This review of the origins of
6 disorderliness, the definition of orderly
7 marketing as contained in the Agriculture
8 Marketing Agreement Act of 1937, as amended, and
9 of its adaption to the changing structure of the
10 milk industry has particular relevance to the
11 outcome of this hearing in the following ways:

12 Never once in either the Nourse or the
13 Milk Pricing Advisory Committee Reports was
14 there a mention of producer-handlers as a source
15 of disorderly marketing. Available Dairy
16 Division data would suggest that when the Nourse
17 Report was written in 1962, there were about 370
18 producer-handlers, and in 1972 about 360. Today
19 there are 37. In 1962 and in 1972, most of
20 these producer-handlers were niche marketing
21 firms delivering milk to homes and struggling to
22 compete and to survive. Today, most
23 producer-handlers are also niche marketing firms
24 and struggling to compete in a much more complex
25 markets and to survive. Yes, some of today's

1 producer-handlers are larger, but so are both
2 cooperatives and conventional processors.

3 Is it just an issue of size? I suspect
4 that for the NP -- NMPF and IDFA it is an issue
5 of size, but it is also an issue of market
6 control. This market control began to evolve at
7 the time the Nourse and Milk Pricing Advisory
8 Committee reports were being written. These are
9 the same pressures that surround the
10 producer-handler issue being discussed in this
11 hearing.

12 But the size issue is substantially
13 different than the NMPF and IDFA would like to
14 have you believe. It can readily be determined
15 from Table 1 that in 1969 there were 343
16 producers for every producer-handler; in 2008
17 there were 1,018 producers for every
18 producer-handler. In 1996 there were 89
19 producers for every handler.

20 JUDGE CLIFTON: Start that one again,
21 please.

22 DR. KNUTSON: In 1969 there were 89
23 producers for every handler.

24 MR. CARROLL: I have 69.

25 DR. KNUTSON: In 2008 there were 143

1 producers for every handler. In 1969 there were
2 3.9 handlers for every producer-handler; in 2008
3 there were 7.1 handlers for every
4 producer-handler. The conclusion I draw from
5 these data is that by every one of these
6 measures, the position of producer-handlers is
7 slipping. The effect of the regulations
8 proposed by the NMPF and IDFA is to either deny
9 the existence of producer-handlers or to put
10 them out of existence. As a matter of national
11 policy, it makes no sense to eliminate the
12 opportunities for producers of all sizes to
13 create independent viable dairy businesses.

14 It is impossible to reason that the
15 existing producer-handler exemption, with only
16 1.46 percent of the fluid milk market and an
17 impact of only about a penny would disrupt the
18 flow of products to market, deny producers an
19 adequate milk -- adequate supply of milk.

20 JUDGE CLIFTON: Let me stop you and have
21 you start again, please, paragraph 47.

22 DR. KNUTSON: It is impossible to reason
23 that the existing producer-handler exemption,
24 with a 1.46 percent of the fluid milk market and
25 an impact of only about a penny a hundredweight

1 would disrupt the flow of products to market,
2 deny consumers an adequate supply of milk, or
3 cause unreasonable fluctuations in the milk
4 supply and prices.

5 Assertion versus reality: Do
6 producer-handlers shift balancing costs?

7 First, it needs to be recognized that
8 cooperative balancing is not just a service to
9 the market. Balancing is an integral part of
10 cooperatives' marketing strategy. That
11 marketing strategy includes the fact that
12 cooperatives get their market power from
13 performing the balancing function. Therefore,
14 balancing is a much big -- is a much bigger
15 benefit to cooperatives than it is a cost to
16 them. The benefit is that it gives them control
17 of the milk supply, which allows them to
18 negotiate full supply contracts. Without
19 balancing, cooperatives would -- could not
20 negotiate either full supply contracts or
21 premiums.

22 Because cooperatives perform the
23 balancing function, who are not cooperative
24 members --

25 JUDGE CLIFTON: Let's start again.

1 DR. KNUTSON: Because cooperatives
2 perform the balancing function, producers, who
3 are not cooperative members, may not have an
4 outlet for their milk. Because cooperatives
5 perform the balancing function, large
6 processors, who do not sign full supply
7 contracts and submit to premium charges, may not
8 have a regular supply -- milk supply as needed.

9 By similar reasoning, cooperatives desire
10 to control the supply -- milk supply of
11 producer-handlers. If they cannot do it
12 overtly, they desire to do it through
13 regulation, which would result if
14 producer-handlers are eliminated. That is,
15 producer-handlers are not cooperative members
16 and will never be as long as they are
17 producer-handlers. Through their proposal,
18 however, the cooperative members of the
19 NMPF greatly enhance their chances of gaining
20 control of producer-handlers' milk supply by
21 putting them out of the business of producing
22 milk, processing milk, or both. This is what
23 appears to be happening in the Pacific Northwest
24 Federal Order.

25 The added advantages that cooperatives

1 gain from balancing involve realizing economies
2 from procurement, capturing economies from
3 producing manufacturing products and profiting
4 from marketing manufactured dairy products.

5 Conventional processors chose not to
6 balance -- choose not to balance -- excuse me,
7 let me start over.

8 Conventional processors choose not to
9 balance because cooperatives' control over the
10 milk supply means that they have no alternative
11 but to use the cooperative as a source of
12 supply. Those that attempt to maintain an
13 independent producer source of supply,
14 experience higher costs in maintaining an
15 independent producer source of supply and
16 consistent pressure from the cooperatives for
17 full supply contracts. Most conventional
18 processors have given in to that pressure.

19 One of the contentions in this hearing is
20 that producer-handlers get a free ride at the
21 expense of cooperatives who perform the
22 balancing function. Responding to this
23 contention requires a look at the facts on both
24 the demand and the supply sides.

25 On the demand side, producer-handlers are

1 effectively prohibited, by Federal Order
2 regulations, from purchasing significant
3 quantities of raw milk, if the regulations
4 permit any purchases of raw milk at all.

5 On the supply side, no data has been
6 produced by the Dairy Programs to indicate the
7 quantities of milk, in excess of their own use,
8 that is put on the market. Based on data that I
9 obtained from six producer-handler AIDA members,
10 in the high sales month, only 13 percent of
11 production was sold on the raw milk market.
12 Most of this milk was sold at the lowest use
13 Class price and carried a large handling charge.
14 Based on the Federal Order milk deliveries and
15 producer-handler sales given in Table 1, the
16 13 percent of raw milk sales by
17 producer-handlers would be 0.64 percent,
18 (six-tenths of one percent) of the 2008 milk
19 deliveries.

20 The factual conclusion is clear:
21 Producer-handlers do not rely on the regulated
22 market to balance their milk supplies.
23 Production levels are managed to correspond to
24 their product sales plus a sufficient surplus
25 capacity to assure adequate milk for bottling.

1 Producer-handlers bear the burden of selling
2 their small surplus on the market at the most
3 advantageous price available, which is almost
4 always at a loss.

5 Evaluation of the proposed regulatory
6 options.

7 AIDA has offered four alternative
8 proposals for consideration at this hearing.
9 The USDA noticed two of these proposals related
10 to the treatment of own-farm produced milk as a
11 single alternative. But it is the intention of
12 I -- of IADA that these alternatives be treated
13 as distinct proposals.

14 JUDGE CLIFTON: Would you read those
15 letters again?

16 DR. KNUTSON: AIDA.

17 JUDGE CLIFTON: Or?

18 DR. KNUTSON: Or?

19 JUDGE CLIFTON: A -- okay. Started with
20 A.

21 DR. KNUTSON: AIDA.

22 JUDGE CLIFTON: Good. Thank you.

23 DR. KNUTSON: The first alternative AIDA
24 proposal, Proposal Number 23, would exempt the
25 own-farm produced milk of any handler from

1 inclusion in the handler's computation of milk
2 value. This alternative would permit any
3 handler who utilizes the milk from farms owned
4 and controlled by the handler to exempt those
5 volumes from regulation. The handler would
6 still be treated as a fully regulated handler or
7 partially regulated handler, pursuant to the
8 terms of the applicable mark -- applicable
9 Marketing Order. But when calculating the
10 handler's producer settlement fund obligations,
11 the handler would down-allocate the volumes of
12 own-farm produced milk to the handler's lowest
13 value use. This alternative would serve two
14 purposes:

15 First, it serves as an alternative to the
16 Draconian and unsupported proposals from the
17 NMPF and IDFA to eliminate producer-handler
18 status in all marketing areas. While Proposal
19 23 would eliminate the need to continue
20 designating producer-handlers as such, it still
21 requires that those handlers who utilize
22 own-farm produced milk demonstrate to the
23 satisfaction of the Market Administrator that
24 the processing facilities and production
25 facilities are under the same ownership and

1 control of the same entity. AIDA intends that
2 the Market Administrator be vested with the
3 authority to conduct such audits of the
4 handler's facilities and record to ensure that
5 there is commonality of ownership and control of
6 those facilities used to produce milk claimed as
7 exempt. It would remain the burden of the
8 handler to demonstrate entitlement to this
9 exemption, as is currently the case with -- with
10 producer-handler designation.

11 Second, Proposal 3 -- second, Proposal 23
12 would permit the handler with own-farm
13 production to purchase milk from the pool
14 sources. But all such purchased milk would be
15 up-allocated to the handler's highest value use,
16 ensuring that pool producers receive the full
17 benefit of all Class I markets served by the
18 handler's purchase of milk from the pool
19 producers.

20 What economic impacts would Proposal 23
21 have on the market for milk? Proposal 23 would
22 allow producer-handlers to continue to exist and
23 compete in an orderly manner. It would allow
24 producers and cooperatives to benefit from
25 producers' sales in excess of their producing.

1 This change in Federal Order regulatory policy
2 would reduce incentives for surplus production.

3 Proposal 23 was also noticed with a
4 second provision, which was submitted by AIDA
5 following the USDA's prehearing information
6 session. This provision, which permits a
7 handler with own-farm production to elect
8 partially-regulated distributing plant status
9 for volumes of its own-farm produced milk, was
10 intended as an alternative to full exemption of
11 own-farm produced milk. This proposal, which
12 AIDA intends to be treated as a distinct
13 proposal, would allow those handlers with
14 own-farm production to treat the volume of --
15 volumes of its own-farm produced milk in the
16 same manner that USDA currently permits
17 partially regulated handlers to treat their milk
18 purchases. This proposal includes language
19 intended to ensure that the handler with
20 own-farm production markets its products at or
21 above its costs, which would be the applicable
22 Class I price plus the costs of manufacturing,
23 processing, handling, marketing, and delivery.
24 The handler with own-farm production would, as
25 to the volumes of own-farm handled milk, place

1 such handlers on the same regulatory footing as
2 partially regulated handlers, who currently
3 distribute milk in any Federal Milk Marketing
4 areas. As to volumes of milk acquired from
5 sources other than the handler's own farm, those
6 volumes would be treated according to the
7 handler's regulatory status as a regulated or
8 partially regulated plant.

9 What economic impacts would this second
10 provision of Proposal 23 have on the market for
11 milk? This provision of Proposal 23 would allow
12 producer-handlers to elect to be a partially
13 regulated plant for milk that it produces. By
14 treating own-farm production in the same manner
15 as USDA currently permits partially regulated
16 plants to treat their milk purchases, this
17 provision allows producer-handlers to continue
18 to exist and compete in an orderly manner. It
19 would allow producers and cooperatives to
20 benefit from producer-handlers' sales in excess
21 of their production. This change in Federal
22 Order regulatory policy would also reduce
23 incentives for surplus production.

24 Proposal 24 is intended for adoption only
25 if USDA adopts -- adopts restrictions on the

1 volumes of producer-handlers. If USDA
2 eliminates the designation of producer-handlers,
3 it is intended that Proposal 24 be incorporated
4 into the Marketing Orders to have the same
5 effect as if incorporated into a
6 producer-handler definition that contains a
7 volume limitation. Under Proposal 24, a
8 producer-handler who disposes of its milk
9 products in retail outlets controlled by the
10 handler or sales direct to the consumer by the
11 handler, would be exempted on those volumes.
12 The rationale for this proposal is that under
13 any legitimate construct -- construct, such
14 sales are entirely controlled by the handler and
15 do not have an impact on the regulated market.
16 Handlers who control the milk supply chain from
17 production through processing and through its
18 final disposition, operate autonomously from
19 orders. AIDA intends this exemption to be
20 liberally construed. For example, if a
21 producer-handler utilizes independent
22 contractors to complete home delivery of its
23 products, but it is the handler who is
24 responsible for the maintenance of those home
25 delivery customers, then the exemption should

1 apply, even if title to the product may pass to
2 the intermediate contractor before delivery to
3 the consumer. In this setting, it is the
4 handler who maintains the responsibility for the
5 retail sales.

6 JUDGE CLIFTON: Doctor, I just want to
7 clarify something that's right in the middle of
8 that paragraph 63 --

9 DR. KNUTSON: Yeah.

10 JUDGE CLIFTON: -- on page 25. There is
11 a sentence that begins: The rationale for this
12 proposal.

13 DR. KNUTSON: Yeah.

14 JUDGE CLIFTON: Now, the last word of
15 that sentence is pool and you read it as market.

16 DR. KNUTSON: Excuse me, no.

17 JUDGE CLIFTON: It may not make a lot of
18 difference, but I want you to read it the way
19 you want it.

20 DR. KNUTSON: Okay. The rationale for
21 this proposal is that under any legitimate
22 construct, such sales are entirely controlled by
23 the handler and do not have an impact on the
24 regulated pool.

25 JUDGE CLIFTON: Thank you. And now then

1 on to paragraph 64.

2 DR. KNUTSON: What economic impacts would
3 Proposal 24 have on the market for milk?

4 Proposal 24 would restrict producer-handlers to
5 outlets that they control. In this sense, it is
6 considerably more restrictive -- it is
7 considerably more restrictive than the current
8 policy. It would allow those producer-handlers
9 that sell directly to consumers to continue to
10 exist and to compete in an orderly manner.

11 Finally, AIDA Proposal 25 would establish
12 individual handler pooling in all markets, as
13 opposed to the current marketwide pools. I will
14 subsequently explain why there are significant
15 economic benefits to individual handler pools
16 over marketwide pools. But here, I want to
17 explain the intent behind the AIDA proposal.

18 The regulatory language in the Notice of
19 Hearing would be effective in creating
20 individual handler pools. The language was
21 submitted to convey AIDA's intentions to do so
22 within the framework of the current regulatory
23 language. In addition to changes that have been
24 noticed, there are conforming changes to the
25 Marketing Orders that would be required to fully

1 implement individual producer-handler pools.
2 Perhaps the most significant --

3 JUDGE CLIFTON: Could you restate again
4 the last part of that sentence? Maybe start
5 again. In addition.

6 DR. KNUTSON: In addition to changes that
7 have been noticed, there are conforming changes
8 to Marketing Orders that would be required to
9 fully implement individual handler pools.
10 Perhaps the most significant would be the
11 elimination of the provisions dealing with pool
12 qualification. As I explain later in my
13 testimony, one of the principal benefits of
14 individual handler pools is that the producers
15 entitled to share in the pooled price are
16 immediately identified by delivering their milk
17 to the plant. Other conforming changes may be
18 required, including determination of whether a
19 distinction between pool plants and partially
20 regulated distributing plants need to be
21 modified. Those specifics are best left to
22 those who formulate Federal Order language. For
23 example, USDA could revert to order language
24 similar to that utilized in previous individual
25 handler pools, such as -- here I strike Federal

1 for -- Upper Peninsula Marketing Order, the
2 Upper Peninsula Marketing Order.

3 JUDGE CLIFTON: And that's on page 26,
4 within paragraph 66. And that paragraph ends as
5 follows, comma --

6 DR. KNUTSON: Such as the Upper Midwest
7 Peninsula Marketing Order.

8 JUDGE CLIFTON: Okay.

9 DR. KNUTSON: Upper Peninsula Marketing
10 Order. I'm sorry.

11 JUDGE CLIFTON: All right. There is no
12 Midwest in there?

13 DR. KNUTSON: No Midwest, no.

14 JUDGE CLIFTON: Okay.

15 DR. KNUTSON: Under individual handler
16 pools, perhaps the single largest change would
17 be made -- would be that manufacturing plants
18 would not necessarily be subject to regulation.
19 Of course, that is the case today. But those
20 plants generally have an incentive to
21 participate in the pool, since under marketwide
22 pooling of returns, their purchases are
23 subsidized by drawing money from the producer
24 settlement fund. This permits producers
25 shipping their milk to manufacturing plants to

1 receive more for their milk than the
2 manufacturing plant actually pays for the milk.
3 In essence, pool distributing plants (and the
4 producers supplying them) subsidize the
5 production of Class III and Class IV products.
6 But when the -- when the USDA minimum prices for
7 Class III and Class IV milk rise rapidly, a
8 price inversion occurs. This occurs because the
9 USDA price formulas that establish the prices
10 for Class I milk lag manufacturing class prices
11 by two months. When a price inversion occurs,
12 manufacturing plants would pay into the producer
13 settlement fund rather than draw from it. So in
14 those instances, manufacturing plants elect not
15 to participate in the pool. This opportunistic
16 depooling has negative effects on the payments
17 to producers who are required to pool their
18 milk. These effects have been described in
19 several hearings held by USDA to address
20 depooling and need not be repeated here.
21 Information on the extent of depooling indicates
22 that efforts to address depooling have not been
23 entirely successful.

24 Benefits -- the benefits of individual
25 handler pools include:

1 First, manufacturing plants, unless they
2 affiliate with distributing plant -- with a
3 distributing plant will not pool their milk.
4 That is no different than under the current
5 marketwide pooling scenario, where manufacturing
6 plants in many instances elect to pool only when
7 it is economically advantageous to do so.

8 Second, the negative effects of
9 opportunistic depooling, which continue to
10 damage producers to the tune of millions and
11 millions of dollars each year, will cease.

12 Third, and perhaps most important, milk
13 in higher use Classes will move to locations
14 where it is needed, thus eliminating the need
15 for call provisions and regulated -- and related
16 regulatory incentives.

17 Fourth, and closely related to the third
18 benefit, all Class I revenues are channeled to
19 those producers who are actually serving the
20 Class I market.

21 Fifth, there is little incentive for the
22 supply area to expand beyond that which is
23 sufficient to serve the needs of the market,
24 thus saving transportation costs.

25 Identifying those producers who serve the

1 market area is a critical function of any
2 Marketing Order. The fact that milk is able and
3 willing to depool suggests that such milk is not
4 ready or necessary to serve the needs of the
5 fluid market. As such, it should not
6 necessarily be entitled to receive the benefits
7 of the order. The Class I utilization of the
8 entire Federal Milk Marketing Order system now
9 stands at approximately 39 percent. This means
10 that under current marketwide pools, more than
11 two times the amount of milk needed to serve the
12 fluid market is receiving the benefits of the
13 fluid market. The intent of the Federal Milk
14 Marketing Order system should not be -- should
15 not be to allow all milk to be pooled, but to
16 ensure that the consuming public has access to a
17 sufficient supply of milk at reasonable prices.
18 That goal can and would be accomplished by the
19 individual handler pools.

20 The proponents of --

21 JUDGE CLIFTON: Excuse me. Before you go
22 on to paragraph 70 -- we're on page 28 -- I just
23 want you to highlight the word fluid that you
24 have in the next to the last sentence, and that
25 you didn't recite --

1 THE WITNESS: A sufficient supply of
2 fluid milk at reasonable prices.

3 JUDGE CLIFTON: Thank you.

4 DR. KNUTSON: The proponents of
5 marketwide pooling will likely assert that
6 individual handler pooling is a move away from
7 equal treatment of producers. However, I have
8 clearly shown with data that producers do not
9 now receive equal prices. Even under individual
10 handler pooling, a cooperative will have the
11 option of continuing to blend its returns among
12 its members.

13 What economic impacts would Proposal 25
14 have on the market for milk? Proposal 25 would
15 treat producer-handlers the same as any other
16 handler, in that it would be its own regulated
17 pool under the order. It would allow
18 producer-handlers to buy milk from other
19 producers at no less than its own blend price
20 based on its utilization as calculated by the
21 Market Administrator. In addition to the
22 benefits discussed previously, it would allow
23 all producer-handlers to continue to exist and
24 compete in an orderly manner. It would allow
25 producers and cooperatives to benefit from

1 producer-handlers' sales in excess of their
2 production. It would reduce incentives for
3 surplus production.

4 Impacts of an unfavorable
5 producer-handler regulatory decision on small
6 business. It is important to recognize that an
7 unfavorable decision to producer-handlers from
8 this hearing would have highly negative effects.
9 These negative effects would not only be on
10 producer-handlers as small business firms, but
11 will extend to consumers who rely on
12 producer-handlers for their milk supply and on
13 the broader milk market. At the risk of
14 repetition, let me summarize by describing the
15 following sequence of negative events: First --

16 JUDGE CLIFTON: Let me interrupt you.
17 You actually called that sequence likely. Is
18 that correct?

19 DR. KNUTSON1: The likely sequence of
20 negative effects, okay?

21 JUDGE CLIFTON: Of negative events?

22 DR. KNUTSON: Negative events, okay.
23 Sorry.

24 First, producer-handlers will be put out
25 of business by producing milk -- out of the

1 business of producing milk, processing milk, or
2 both.

3 Some portion of the bottling business
4 will go to conventional -- will go to large
5 conventional processors, and over time all of it
6 will likely end up there.

7 Substantially all of the milk volume will
8 be handled by the dominant cooperative.

9 Employment will decline, particularly in
10 rural areas where most of these firms are
11 located.

12 Milk consumption will continue to decline
13 as the innovations fostered by smaller business
14 firms are lost.

15 Concluding remarks.

16 In considering whether a national policy
17 change eliminating the historic producer-handler
18 status is justified, it is essential for the
19 USDA to fully consider the characteristics of
20 the U.S. milk market today. Class I milk is no
21 longer the dominant milk usage in the national
22 market. From Table 1 it can be determined that
23 fluid milk utilization has shrunk from a
24 national average of 64.3 percent in 1969 to a
25 national average of 38.7 percent in 2008. Based

1 on FAPRI data, it could decline to 34.7 percent
2 in 2017. In its narrative on the dairy outlook
3 and situation, FAPRI notes that, quote, Fluid
4 milk consumption is expected to continue to
5 decline over the baseline, unquote. FAPRI then
6 concludes that, quote, Changes in fluid milk
7 consumption are having smaller effects on
8 producer milk prices because a smaller
9 percentage of the milk production is used for
10 fluid purposes, unquote. The data equivalently
11 indicates that cows' milk faces stiff
12 competition from fluid milk substitutes, whether
13 it be soymilk, goat milk, juices fortified with
14 calcium, other juices, soft drinks, teas,
15 coffee, or water in its proliferating number of
16 forms. A regulatory system that fails to
17 account for the fact -- that fact and continues
18 to promote concentration on a shrinking fluid
19 milk market share -- fluid market share serves
20 no one, not producers, not cooperatives, not
21 processors, not producer-handlers and not
22 consumers.

23 It is time that the milk industry and the
24 firms that represent it focus on the reality of
25 today's milk markets. Milk is no longer a

1 homogenous commodity and should not be regulated
2 as such. Producers are an important part of the
3 milk industry.

4 JUDGE CLIFTON: Start that sentence
5 again, please.

6 DR. KNUTSON: Producers are an important
7 part of the milk industry.

8 JUDGE CLIFTON: I agree. Are you wanting
9 there to focus on --

10 DR. KNUTSON: Producer-handlers. Excuse
11 me, I'm sorry. Producer-handlers are an
12 important part of the milk industry, not in
13 terms of the volume and the share of the market,
14 but in terms of the products, innovations, and
15 customers they serve. They are not a threat to
16 anyone and should not be treated as such. They
17 are producers who have chosen to innovate and
18 also be processors. They have expanded the
19 market for milk and its products. The members
20 of AIDA have proposed a set of viable options --
21 viable Federal Order options for allowing these
22 firms to survive.

23 Finally, the AIDA proposals are designed
24 to move national dairy policy in the direction
25 of achieving the type of equitable competitive

1 dairy industry balance between
2 producer-handlers, processors, and cooperatives
3 that was envisioned by the Nourse Report. In
4 fact, this proposal by NMPF and IDFA has nothing
5 to do with reducing disorderly marketing. For
6 NMPF, it is designed to prevent producers from
7 leaving cooperatives to operate processing
8 plants. Therefore, an otherwise hidden
9 objective of the NMPF proposal is to severely
10 limit the value-added options available to milk
11 producers. For IDFA it provides a means of
12 reducing the number of competitors and,
13 therefore, competition within the dairy
14 industry. Any of the options proposed by AIDA
15 makes more economic sense as national Federal
16 Order policy than the alternative presented by
17 NMPF and IDFA petitioners, because it retains
18 milk producers' options for the future and
19 allows producer-handlers to survive and continue
20 to build the market for milk.

21 JUDGE CLIFTON: I had one other question
22 about the way you read your statement,
23 Dr. Knutson. Would you turn to page 9?

24 DR. KNUTSON: Yes.

25 JUDGE CLIFTON: I mean page 8.

1 DR. KNUTSON: What's the item?

2 JUDGE CLIFTON: Do you see at the top of
3 your bullet point, the first year you show there
4 is October 1969?

5 DR. KNUTSON: Right.

6 JUDGE CLIFTON: For the first month.
7 Then in the next paragraph, paragraph 18, you
8 use the year 1960 without having given us data
9 except '69.

10 DR. KNUTSON: Yeah.

11 JUDGE CLIFTON: Which makes me think you
12 mean '69.

13 DR. KNUTSON: No, it's '60 and the data
14 is given in the -- by the Dairy Programs in
15 their basic table on numbers.

16 JUDGE CLIFTON: Okay. So -- so the
17 number of producer-handlers is 421 --

18 DR. KNUTSON: Ah, I see what you're
19 saying.

20 JUDGE CLIFTON: -- both in '60 and '69?

21 DR. KNUTSON: I would have to check on
22 the exhibit that that's in.

23 JUDGE CLIFTON: Would you?

24 DR. KNUTSON: Yes.

25 JUDGE CLIFTON: And then you can report

1 back to us which way you want that page.

2 DR. KNUTSON: I will. Could be a typo.

3 JUDGE CLIFTON: Good. And I appreciate
4 so much the care with which you've put together
5 this statement.

6 How do you want, Mr. Miltner, to address
7 what is left in this exhibit?

8 MR. MILTNER: I would suggest, your
9 Honor, that we're going to have some brief
10 direct examination. I know Dr. Knutson has been
11 speaking for almost an hour again, and I'd like
12 to try to coordinate those questions with
13 Mr. Ricciardi so we're not duplicative and we
14 can organize this. I would suggest ten minutes
15 if we could.

16 JUDGE CLIFTON: That would be -- that is
17 an excellent idea. Thank you. Let's see. It
18 is 4:40. Please be back and ready to go at
19 4:50.

20 (A recess was taken from 4:40 to 4:51.)

21 JUDGE CLIFTON: We're back on record at
22 4:51. Dr. Knutson, there was one other question
23 I had on page 30 and that is your reference to
24 FAPRI, F-A-P-R-I. I don't know what that is.

25 DR. KNUTSON: FAPRI. I think it's

1 referenced in the footnotes.

2 JUDGE CLIFTON: Okay.

3 DR. KNUTSON: I hope. It's --

4 JUDGE CLIFTON: It's page 30. I see a
5 website and it has something to do with Iowa
6 State.

7 DR. KNUTSON: Yeah. FAPRI is the Food
8 and Agriculture Policy Research Institute.

9 JUDGE CLIFTON: Ah, good.

10 DR. KNUTSON: At Iowa State University
11 and the University of Missouri.

12 JUDGE CLIFTON: Very good. Thank you so
13 much. Mr. Miltner.

14 MR. MILTNER: Thank you, your Honor. I
15 have some, what I hope to be relatively brief,
16 questions here on direct. And we'll start with
17 Dr. Knoblauch.

18 And I wanted to start initially with the
19 chart that's attached to your statement because
20 I don't think we had a chance to describe that.
21 If you could give us an idea of the data on that
22 and what that chart depicts.

23 DR. KNOBLAUCH: This is the last page to
24 my testimony, Exhibit 90, and that last page
25 shows the raw data as well as a graphic

1 representation of the costs of production, both
2 from the Dairy Farm Business Summary and from
3 the Economic Research Service in comparison to
4 the Federal Milk Marketing Order Number 1
5 uniform price, Southwest Class I price in that
6 same order.

7 MR. MILTNER: And the data, the source
8 data on that chart is -- is from your -- your
9 Cornell data and USDA-ERS and USDA sources, is
10 that right?

11 DR. KNOBLAUCH: That's correct.

12 MR. MILTNER: Your Honor, could you
13 provide Exhibit 23 for us, please?

14 JUDGE CLIFTON: Certainly. And Exhibit
15 23 is the statement from the National Milk
16 Producers Federation, Dr. Cryan.

17 Dr. Knoblauch, if you could turn to page
18 11 of that and take a look at it? First of all,
19 have you had a chance to see that testimony
20 before?

21 DR. KNOBLAUCH: I have seen his
22 testimony. I don't know if it was in exactly
23 this form or not but --

24 MR. MILTNER: Okay. If you could turn
25 to -- if you saw his testimony, then that's --

1 that's what you had seen.

2 DR. KNOBLAUCH: Okay.

3 MR. MILTNER: I want you to look at page
4 11 and there's a -- there's a graph on that
5 page. Do you see the graph there?

6 DR. KNOBLAUCH: Yes, I do.

7 MR. MILTNER: Have you had a chance to
8 see that graph in that form before?

9 DR. KNOBLAUCH: Yes, as presented in
10 Exhibit 23.

11 MR. MILTNER: Okay. Have you had the
12 chance to, before now, read the statement that
13 accompanies that chart in the statement?

14 DR. KNOBLAUCH: Yes, I have.

15 MR. MILTNER: Okay. Do you think that
16 the chart, as depicted there, accurately
17 reflects the -- the achieved economies of dairy
18 farms based on your research and the other data
19 that you have reviewed?

20 DR. KNOBLAUCH: Well, I think the first
21 point to be made is that while the data points
22 represented in this graph do come directly from
23 an ERS USDA publication, placing them on a graph
24 such as this and then providing the
25 interpretation that he has done is, at best,

1 misleading.

2 MR. MILTNER: How would you interpret the
3 same data? You say the interpretation that's
4 provided and the graph is misleading. First of
5 all, what do you find misleading about the way
6 it's been presented here?

7 DR. KNOBLAUCH: Well, basically the
8 largest herd size category is greater than a
9 thousand cows, the average of which is something
10 over 2,000 cows. So that's a very, very large
11 interval from a thousand to more than 2,500 or
12 about 2,500 is my memory. And to just find a
13 midpoint and say that it goes down directly,
14 that slope between the average of herds between
15 500 and a thousand cows and herds over a
16 thousand just is not true.

17 MR. MILTNER: If you look at the last
18 point on that chart, is that point approximately
19 where that average herd size is in that large --
20 that large category, based on your knowledge of
21 the ERS study?

22 DR. KNOBLAUCH: Yes. This is going from
23 memory, but I believe the average of that larger
24 herd size category was something like 2,083
25 cows.

1 MR. MILTNER: Okay. Is there a more
2 accurate way to depict what that curve would
3 look like in your opinion?

4 DR. KNOBLAUCH: Yes. In the same
5 publication there's another graph a few pages
6 later which describes both the average as well
7 as an economic frontier that was computed. And
8 that would be the appropriate data to rely upon
9 especially as it relates to determining what
10 that cost curve -- or I should say the shape of
11 that cost curve is out at the larger herd sizes.

12 MR. MILTNER: And then that study that
13 the data is taken from is the ERS report Number
14 47 titled, Profits, Costs and the Changing
15 Structure of Dairy Farming?

16 DR. KNOBLAUCH: That's correct.

17 MR. MILTNER: And cited as a reference in
18 your testimony as well?

19 DR. KNOBLAUCH: Yes, it is.

20 MR. MILTNER: And that's the ERS data
21 that you have relied upon and some of the
22 opinions you've put forth in your statement?

23 DR. KNOBLAUCH: That's correct.

24 MR. MILTNER: Okay. So same data,
25 different interpretations?

1 DR. KNOBLAUCH: Actually, same report.
2 This data that Dr. Cryan relies upon is in that
3 report, but then the report goes on and does
4 further analysis and explains an analysis to
5 take this data a step farther.

6 MR. MILTNER: And is it that frontier you
7 described that's contained in the ERS
8 publication? Is that what you rely upon for
9 your statement that scale economies virtually
10 disappear after 1,250 cow herd size is attained?

11 DR. KNOBLAUCH: That is correct.

12 MR. MILTNER: And that statement is
13 quoted. I quoted it from page 2 here of your
14 statement, is that right?

15 DR. KNOBLAUCH: That's correct.

16 MR. MILTNER: You've had a chance to
17 review and study the Cornell fluid milk
18 processing plant study. And you referred to
19 that in your statement, is that right?

20 DR. KNOBLAUCH: That's correct.

21 MR. MILTNER: And you've had a chance, I
22 assume, not only to review the study but discuss
23 that -- that research with its authors, who are
24 also at Cornell?

25 DR. KNOBLAUCH: Yes, I discussed that

1 with Dr. Stephenson.

2 MR. MILTNER: Okay. Does that report
3 suggest or document that a plant anywhere near
4 450,000 pounds of processing volume a month can
5 compete at all with a modern, even modestly
6 sized fluid milk processing plant?

7 DR. KNOBLAUCH: No. That report clearly
8 shows that even at 30 million pounds and
9 40 million pounds and up that there are still
10 economies of scale being realized.

11 MR. MILTNER: Okay. So would you come to
12 the same conclusion for a 3 million pound per
13 month processing plant, that it does not compete
14 on the same economies of scale as those large
15 plants?

16 DR. KNOBLAUCH: Not on economic only
17 criteria, that's correct.

18 MR. MILTNER: If you could pass the
19 microphone over to Dr. Knutson.

20 Dr. Knutson, let's start the same way
21 that we did with Dr. Knoblauch's questions, and
22 look at the -- the charts and data that you
23 attached to your statement. Now, you -- I think
24 you referred to all of them a little bit, but if
25 you could just walk us through them one by one

1 beginning with Figure 1 and give us an idea of
2 what's being depicted on these attachments.

3 DR. KNUTSON: Figure 1 is the number of
4 producer-handlers operating in Federal Orders as
5 reported by Dairy Programs in the indicated
6 publication.

7 MR. MILTNER: Okay.

8 DR. KNUTSON: It's in the record, I'm
9 sure.

10 MR. MILTNER: It is. And I believe it's
11 Exhibit 7. I don't know if -- your Honor, if we
12 want to formally identify that or not. The
13 title of the document is exactly the same.

14 JUDGE CLIFTON: I think what you just did
15 takes care of it.

16 MR. MILTNER: Okay.

17 MR. BESHORE: Exhibit number?

18 DR. KNUTSON: I'd like to turn next to --

19 MR. MILTNER: One second. There's not a
20 question.

21 DR. KNUTSON: I'm sorry.

22 JUDGE CLIFTON: What is the question?

23 MR. BESHORE: What exhibit? I'm sorry.
24 I didn't hear what exhibit was referred to.

25 MR. MILTNER: Exhibit 7.

1 MR. BESHORE: Thank you, Mr. Miltner.

2 JUDGE CLIFTON: And that is the same
3 picture as which graph?

4 DR. KNUTSON: Figure 1.

5 JUDGE CLIFTON: Figure 1, okay. Figure 1
6 attached to Exhibit 89 is the same as Exhibit 7.
7 Thank you.

8 MR. MILTNER: It's not the same, but it's
9 the data that was sourced -- was sourced from
10 what is Exhibit 7.

11 JUDGE CLIFTON: Thank you.

12 DR. KNUTSON: Okay. I'd like to turn to
13 Table 1 next, because the other figures relate
14 to Table 1 and the data in Table 1. So it's
15 better to cover that first. This is all --

16 JUDGE CLIFTON: Let us catch up with you.
17 Table 1 is a few more pages into the
18 attachments?

19 DR. KNUTSON: Yeah, after the figures.

20 JUDGE CLIFTON: Okay. I have mine. Is
21 everybody with Dr. Knutson?

22 THE WITNESS: It's titled, Comparison of
23 Annual Average Size and Growth of Producers,
24 Handlers and Producer-Handlers, Selected Years.
25 All of the data in that table are from posted

1 documents, I believe, as indicated there. The
2 exception, as I indicated in my testimony,
3 relates to the producer-handler volume for 1969,
4 1980, and 1992.

5 And the Dairy Programs gives the percent
6 of producer-handler sales in that same Exhibit 7
7 referred to previously. And I simply multiplied
8 that by the Class I utilization or sales volume
9 for the indicated years. And so the
10 producer-handler sales volume is an estimated
11 sales volume based upon the percent of Class I
12 sales for those years which is in the Federal
13 Order data that's been a part of this hearing.
14 So that's -- that's where that comes from.
15 Otherwise, they're all numbers that relate to
16 posted material.

17 MR. MILTNER: So it's -- other than as
18 noted, it's USDA data, much of which was posted
19 to the USDA website for this hearing?

20 DR. KNUTSON: Exactly.

21 MR. MILTNER: -- and you're -- maybe we'd
22 be quicker if we do this before. The fourth --
23 fourth source table titled, Packaged Disposition
24 of Class I Milk Products by Handlers Regulated
25 under Federal Milk Orders, by Product, 2000 to

1 2008 appears to be Exhibit 9, same title. And
2 if we want to have Dr. Knutson identify it,
3 that's fine. But he's identified the source as
4 USDA website and the title of the document is
5 identical.

6 MR. YALE: And that's for this Table 1?

7 MR. MILTNER: Yes.

8 JUDGE CLIFTON: On Table 1 look at the
9 sources and go down to the fourth source. You
10 see there are a number of sources for this Table
11 1. And the fourth source is Exhibit 9.

12 MR. MILTNER: The next source is titled
13 Sales of Fluid Milk Products in Federal Milk
14 Order Marketing Areas, by Producer-Handler, by
15 order, 2000 through 2008. It appears to be
16 exactly the same as the title on Exhibit 12.

17 JUDGE CLIFTON: Which numbered source is
18 this on Table 1?

19 MR. MILTNER: The fifth source.

20 JUDGE CLIFTON: Okay. And that is
21 Exhibit --

22 MR. MILTNER: 12.

23 JUDGE CLIFTON: -- 12.

24 MR. MILTNER: And the next source appears
25 to be Exhibit 13, Producer-Handler Regulatory

1 Status 2005 to 2009.

2 JUDGE CLIFTON: Thank you, Mr. Miltner.
3 That's very helpful. Is everybody with him?

4 MR. TOSI: No, your Honor. Can we run
5 through that again?

6 MR. MILTNER: Now, the first one,
7 Dr. Knutson, is Dairy Market Notes, the first
8 source on there?

9 DR. KNUTSON: Actually, that's Federal
10 Market Order statistics. Your Table 2, measures
11 of growth.

12 JUDGE CLIFTON: We're still on Table 1.

13 MR. MILTNER: I'm sorry, we're looking at
14 Table 1.

15 DR. KNUTSON: I know, yeah. It's data on
16 producers, handlers, deliveries, and utilization
17 1962 to '92. And that was obtained from Dairy
18 Programs table 2, Measures of Growth in Federal
19 Milk Market Order Markets, years 1947 to 2006
20 and then -- and then also from the Dairy Market
21 News for the last two years. The first one only
22 went through 2006. And the last two years picks
23 up 2007 and 2008.

24 JUDGE CLIFTON: Good. That's helpful.
25 So everyone is with him so far on the first

1 source on Table 1?

2 MR. MILTNER: And the second source is
3 Exhibit 7, is that right, Dr. Knutson?

4 DR. KNUTSON: Yes.

5 MR. MILTNER: The third one is data you
6 had calculated as described in your testimony,
7 right?

8 DR. KNUTSON: Right, right.

9 MR. MILTNER: Okay. The next source is,
10 I believe we said, Exhibit 9. And then Exhibit
11 12 for the next source, and Exhibit 13.

12 MR. TOSI: Thank you.

13 DR. KNUTSON: Figure 2.

14 MR. MILTNER: Okay.

15 DR. KNUTSON: Figure 2 is simply the
16 sales by producer-handlers, which is one of the
17 columns. It's the average.

18 MR. MILTNER: And the source for that is
19 the data we just described in Table 1?

20 DR. KNUTSON: Yeah -- no, it's the
21 producer-handler sales volume. I'm sorry. It's
22 not the average, okay?

23 MR. MILTNER: Okay.

24 MR. TOSI: The source for that?

25 DR. KNUTSON: Table 1.

1 MR. MILTNER: Yes.

2 DR. KNUTSON: And the same is true of the
3 next one. It's the percent sales by
4 producer-handlers in Federal Order markets.
5 It -- it is in Table 1 but it's also in the
6 Exhibit 7.

7 MR. MILTNER: Okay.

8 DR. KNUTSON: And Figure 4 is the
9 difference in net pay to producer-handlers in
10 New York -- ah, that's related -- let's look at
11 one of the other figures. Let's look at the
12 other tables and then we'll get to Figure 4.

13 MR. MILTNER: Okay. Which table would
14 you like us to turn to?

15 DR. KNUTSON: 2. Table 2, the source of
16 that is -- is the Federal Order small plant
17 structure information and that's posted
18 information. It was also appended to the
19 IDFA -- excuse me, National Milk Producers
20 Federation.

21 MR. MILTNER: And that's for May 2008?

22 DR. KNUTSON: For May. It is for
23 May 2008, yeah.

24 MR. MILTNER: And that is Exhibit 18?

25 DR. KNUTSON: Yeah. Okay.

1 DR. KNUTSON: Then Table 3 is the Class I
2 Cooperative Premiums. In fact, Table 3, 4 and 5
3 are all Class I cooperative premiums and they
4 are all from -- they can all be found in Dairy
5 Market News.

6 MR. MILTNER: Okay.

7 DR. KNUTSON: But the annual summaries
8 are contained in Dairy Market statistics for the
9 years indicated. So I'm not sure that these
10 are -- whether these are in exhibit form here or
11 not, but they're all USDA publications.

12 MR. MILTNER: I don't believe those are
13 in exhibit form. But as you indicate, both
14 Dairy Market News and Dairy Market statistics
15 Annual Summary are USDA published compilations
16 of statistical material.

17 DR. KNUTSON: Yes. The markets covered
18 in Table 4 and 5 for premiums are -- I picked
19 them. I didn't pick them for any particular
20 reason except to get geographic distribution on
21 them. And I wanted to include Chicago because
22 of the importance of Chicago as an indicator of
23 what the release charges or the give-up charges
24 might be in that -- in the Minnesota-Wisconsin
25 area, because most economists, as I indicated in

1 my testimony, feel that since USDA doesn't
2 report give-up charges, that it's the best
3 indicator of the movement in those -- in those
4 give-up charges, if it doesn't actually reflect
5 the actual level of those give-up charges.

6 MR. MILTNER: Okay.

7 DR. KNUTSON: And Table 4 is for April
8 and Table 5 is for October. And the reason for
9 April and October is, April is generally one of
10 the peak flush months. It's after pastures get
11 green and the calves are born and so forth. And
12 October is usually one of the shortest months.
13 So it provides a combination of the flush season
14 and the short supply season of the year.

15 And Table 6 is from the work of Mark
16 Stephenson that Knoblauch referred to, and I --
17 I simply obtained that from Stephenson's
18 publications, as indicated. And then Figure 4
19 simply plots that data over the time period so
20 you can visualize how much difference there is
21 between the two.

22 In Table 6, the blend prices were
23 obtained from the Northeast Marketing Order
24 Administrator's report.

25 MR. MILTNER: Okay. Thank you. I may

1 have a few more questions about specific points
2 of your testimony here.

3 Dr. Knutson, are you familiar with the
4 term, compensatory payment, in Federal Milk
5 Marketing Order language?

6 DR. KNUTSON: Yeah. It's a payment into
7 the pool by a plant.

8 MR. MILTNER: And you may need to pull
9 the mic a little closer.

10 DR. KNUTSON: Excuse me. It's a payment
11 into the pool by a plant.

12 MR. MILTNER: Okay.

13 DR. KNUTSON: The proposal by National
14 Milk and IDFA would require a compensatory
15 payment of producer-handlers of the difference
16 between the uniform price and the Class I price.

17 MR. MILTNER: Or the plants' blend price
18 based on their utilization, right?

19 DR. KNUTSON: Yes.

20 MR. MILTNER: Okay. So that's a
21 compensatory payment. And the base for the
22 compensatory payment is that of the blend price?

23 DR. KNUTSON: Yes, the Federal Order
24 blend price.

25 MR. MILTNER: Federal Order blend price.

1 Now, are you familiar also with the term
2 transfer price? I think you reference it in
3 your statement.

4 DR. KNUTSON: Yes.

5 MR. MILTNER: Transfer price,
6 compensatory payment base, how are those
7 concepts linked, if at all?

8 DR. KNUTSON: They're directly linked to
9 one another because the proposal links the
10 transfer price to the -- the blend price, the
11 uniform blend price. So the -- the proposal is
12 directly linked to compensatory payment.

13 In other words, the difference in the
14 payment between the uniform price and the Class
15 I price is the compensatory payment.

16 MR. MILTNER: And from a -- from an
17 economic perspective, does it -- does it make
18 sense to -- to assign the transfer price at the
19 same point as the base price for the
20 compensatory payment? In other words, you
21 criticized the transfer price is set at the
22 blend, and why is that?

23 DR. KNUTSON: Because that's -- that's
24 what they propose. That's their proposal.

25 MR. MILTNER: And from your perspective,

1 as an economist, the rational point to set that
2 is not at the blend price but at their
3 production?

4 DR. KNUTSON: Is at the cost of
5 production of the producer-handler. I mean, the
6 rationale is that you base the transfer price on
7 the market price. You don't base a transfer
8 price on a regulated Federal Order price that
9 doesn't exist in the market.

10 So, you know, the best basis that you've
11 got for what that transfer price is by a
12 producer-handler is the producer-handler's cost
13 of production.

14 MR. MILTNER: You've been studying
15 Federal Order policy for a while, and the
16 statement -- the statement is made by several
17 people in this hearing that producer-handlers of
18 the size we're seeing today were never
19 contemplated at the time the Marketing Orders
20 were adopted. Were the marketing orders
21 intended or contemplating farms at all in sizes
22 that we see today?

23 DR. KNUTSON: No. And, of course, they
24 didn't contemplate --

25 JUDGE CLIFTON: Closer to the mic,

1 please.

2 DR. KNUTSON: No, it did not contemplate
3 farms of the size we have today, nor did it
4 contemplate processors of the size we have
5 today.

6 MR. MILTNER: And how -- in your
7 experience have the terms of the Marketing
8 Orders generally been neutral as to the size of
9 a farm?

10 DR. KNUTSON: I guess I don't understand
11 the question. Are you saying, do Marketing
12 Orders discriminate based upon the size of the
13 farm?

14 MR. MILTNER: Yes.

15 DR. KNUTSON: Let me answer the question
16 in this way. In terms of the fact that
17 producers get paid based on volume, whether
18 under a Marketing Order or not, favors larger
19 farms. And -- and -- and so any regulation that
20 results in higher returns to a particular -- to
21 producers in general benefit large producers
22 more than small producers.

23 MR. MILTNER: Just a couple more
24 questions about some points in your statement.
25 If you could look at paragraph 36 on page 16,

1 please.

2 DR. KNUTSON: Okay.

3 MR. MILTNER: You talk about in your
4 second bullet point, a niche farm, such as the
5 AIDA members, generally sell their products at
6 prices that are substantially higher than that
7 of conventional homogenous milk.

8 DR. KNUTSON: Yes.

9 MR. MILTNER: Some of the members in your
10 area, as you found, don't do that?

11 DR. KNUTSON: Correct. That's covered
12 in -- I was going to say it's covered in the
13 last point, but it's covered in another point.

14 MR. MILTNER: It is covered?

15 DR. KNUTSON: Yes.

16 MR. MILTNER: And I want to make sure
17 that that's clear on the record, that a niche
18 market, in a sense, can be supplying competition
19 to a market that's otherwise dominated or
20 monopolized, is that -- is that right?

21 DR. KNUTSON: Well, you know, I'm not
22 sure that I would put it in that context. I
23 would say there are niche markets that serve
24 particular segments of consumers and then there
25 are markets that are contestable markets;

1 economists refer to them as contestable markets,
2 where the margins are sufficiently high. The
3 prices charged are sufficiently high that they
4 invite competition. And that's the other
5 circumstance. I wouldn't refer to that
6 necessarily as a niche market. It's a
7 contestable market concept.

8 MR. MILTNER: Thank you for that more
9 accurate description of a contestable market.

10 I want to look quickly at paragraph 67 on
11 page 26.

12 DR. KNUTSON: Yes.

13 MR. MILTNER: It begins on the last line
14 on that page. I want to make sure we've
15 described something correctly -- or you've
16 described something correctly. It says, but
17 when the USDA minimum prices for Class III and
18 IV milk rise rapidly, a price inversion occurs?

19 DR. KNUTSON: Yes.

20 MR. MILTNER: I think it's just a
21 misstatement of the order in which prices rise.
22 Normally, the Class I prices rise rapidly and
23 that is what creates the inversion. Am I -- is
24 my recollection correct?

25 DR. KNUTSON: No. The manufacturing

1 price is the one that rises above.

2 MR. MILTNER: Okay. My apologies.

3 DR. KNUTSON: That's why they depool.

4 It's interesting -- if I could --

5 MR. MILTNER: Please.

6 DR. KNUTSON: The Milk Pricing Advisory
7 Committee -- I don't think the Nourse Report,
8 but the Milk Pricing Advisory Committee
9 discussed this issue in some detail. And I
10 might say the Milk Pricing Advisory
11 Commission -- Committee was composed almost
12 entirely of USDA experts, warned against forward
13 pricing because of the potential of undermining
14 the orders. And yet we have forward pricing.

15 MR. MILTNER: I appreciate that
16 observation. I do appreciate the observation.
17 Your Honor, we don't have any more direct
18 examination. Thank you.

19 JUDGE CLIFTON: And, Dr. Knutson, I
20 understand that you have authorized a change on
21 page 8, paragraph 18, the second line. The 1960
22 there is actually '69, is that correct?

23 DR. KNUTSON: Yes.

24 JUDGE CLIFTON: Good. Thank you.

25 So Mr. Miltner, what do you move into

1 evidence?

2 MR. MILTNER: I would like to move in
3 Exhibit 89 and 90. I think 91 was admitted
4 previously.

5 JUDGE CLIFTON: It was indeed. Is there
6 any objection to the admission into evidence of
7 Exhibit 89 or 90? Mr. English?

8 MR. ENGLISH: I do not object to
9 Exhibit 90. I'd like, as part of my
10 cross-examination, which I think I will start
11 tomorrow morning, to be able to voir dire on
12 Exhibit 89 before I decide whether I'm going --
13 what I'm going to do.

14 JUDGE CLIFTON: All right. Does anyone
15 have any objection to Exhibit 90, which is
16 Dr. Knoblauch's statement? Is there any
17 objection at all on that being admitted? There
18 is none. I hereby admit into evidence Exhibit
19 90.

20 JUDGE CLIFTON: With regard to Exhibit
21 89, I will allow Mr. English the opportunity to
22 voir dire, and then we'll see where we go from
23 there on that statement. All right. Let me see
24 what time it is, so I can see if we want to
25 begin Dr. Yonkers tonight. We could get some

1 cross of Dr. Yonkers in, though if I'm going to
2 let you go at 6:00, that's only half an hour.

3 MR. ENGLISH: Your Honor, I think if
4 nothing else than to be consistent with my
5 statements earlier today, since we don't know
6 how long the cross would go, I think we should
7 at least get started on that, that
8 cross-examination.

9 JUDGE CLIFTON: I think that's a good
10 idea. If by some miracle we finish tonight,
11 that would be wonderful, and then Drs. Knoblauch
12 and Knutson would know that they were first up
13 at 8:00. So gentlemen, thank you very much.
14 You may step down for now. Let's take -- can
15 we really limit it to five minutes just to
16 stretch?

17 MR. ENGLISH: Yes. Yes, your Honor.

18 JUDGE CLIFTON: Thank you. Please be
19 ready to go at 5:35.

20 (A recess was taken from 5:30 to 5:36.)

21 JUDGE CLIFTON: We're back on record at
22 5:36. Dr. Yonkers was our cleanup batter on 12
23 May. That was only two days ago. And he's our
24 cleanup batter today as well. Who would like to
25 begin the cross-examination of Dr. Yonkers?

1 MR. VETNE: Your Honor, John Vetne. I
2 don't have any cross-examination for
3 Dr. Yonkers. I probably won't because his
4 testimony more or less adopts NMPF's and so
5 unless there's a wrinkle added by co-proponents
6 in more quasi direct, I don't think I will have
7 any.

8 JUDGE CLIFTON: Thank you, Mr. Vetne.
9 Who else would like to cross-examine
10 Dr. Yonkers?

11 JUDGE CLIFTON: Mr. Tosi, do you have any
12 questions for Dr. Yonkers?

13 MR. YALE: No, your Honor. Right now we
14 have no questions.

15 JUDGE CLIFTON: Is there any objection to
16 the admission into evidence of Exhibit 80?
17 There is none. Exhibit 80 is hereby admitted.

18 JUDGE CLIFTON: Is there anything further
19 before we adjourn for the day? Mr. Yale?

20 THE WITNESS: He just can't do it.

21 MR. YALE: This has nothing to do with
22 Dr. Yonkers. He is a very light witness.
23 That's an inside joke.

24 You know, maybe we can argue about how to
25 do the cross for Knutson and Knoblauch tonight,

1 and then that would take care of it because we
2 spent more time about how we were doing his
3 cross than doing his cross, but I have nothing.

4 MR. ENGLISH: I said it first.

5 JUDGE CLIFTON: You know, I hate to let
6 him off this light. He -- he has had the
7 easiest time of any witness who came here. That
8 does not seem right.

9 MR. RICCIARDI: Why don't you ask him
10 some questions?

11 THE WITNESS: Thanks, Al.

12 MR. HOLLON: Let's hear those magic
13 words.

14 JUDGE CLIFTON: You know, I had some
15 areas noted, but it doesn't seem to matter now.
16 All right. I'll see you all at 8:00 in the
17 morning. Thank you very much. We go off record
18 at 5:45.

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20 PROCEEDINGS ADJOURNED AT 5:45 p.m.

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C E R T I F I C A T E

I, S. Diane Farrell, RMR, CRR, the undersigned, a court reporter for the State of Ohio, do hereby certify that at the time and place stated herein, I recorded in stenotypy and thereafter had transcribed into typewriting under my supervision the foregoing pages, and that the foregoing is a true, complete and accurate report of my said stenotype notes.

S. Diane Farrell, RMR, CRR