UNITED STATES DEPARTMENT OF AGRICULTURE
BEFORE THE SECRETARY OF AGRICULTURE

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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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Kate Fisher, USDA
Jack Rower, USDA
Clifford M. Carman, USDA
Gino Tosi, USDA
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JUDGE CLIFTON: We're back on record at 8:02. It's Thursday, May 14, 2009. We're in Cincinnati, Ohio. And this is day 9 of the milk rulemaking hearing. I'm Judge Jill Clifton, U.S. Administrative Law Judge, and I'd like to talk now about the schedule for tomorrow, and Monday. Well, today, tomorrow and Monday.

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

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

Now, a full day on Friday means until 5:00. We have the room until 5:00. Is there anyone who has any serious objection to us working here in the hearing until 5:00 tomorrow?
No objection. No serious objection. I appreciate that.

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

Anyone? Mr. Vetne.

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

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

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

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

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

JUDGE CLIFTON: How soon can you distribute your letters?

MR. VETNE: They've been distributed for a couple of months. They're online. They're the supporting -- the letters supporting the proposals. Everybody has got a copy. If you need more paper copy, I could kill a couple of trees and distribute them. But they're there. They've been there for a month or more.
JUDGE CLIFTON: Okay. So your purpose in testifying is to have those marked as exhibits and come in as exhibits?

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

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

MR. VETNE: Yes.

JUDGE CLIFTON: Or anybody else in the room?

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

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

MR. VETNE: It's not my modification to make, but my clients have modified the proposal
in one respect and that is to establish a second hard cap. There's a first hard cap on exempt milk and the second hard cap that Mr. Flanagan described on a larger size at which exempt -- the possibility of exempt milk will apply.

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

JUDGE CLIFTON: When did that modification come in?

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

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

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

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

MR. VETNE: Mr. Flanagan has already done
that. I will take care of it, your Honor --

JUDGE CLIFTON: Okay.

MR. VETNE: -- whatever is required.

JUDGE CLIFTON: Okay. Just don't --

don't use your documents to confuse us. You may

have to, I think, align them with your position.

MR. VETNE: My client's position, I --
you're right. Just to bring everybody up to

speed, I may take 60 or 90 seconds to refer back
to Mr. Flanagan's testimony and say, here's the

modification applied to these proposals.

JUDGE CLIFTON: Okay.

MR. VETNE: Thank you.

JUDGE CLIFTON: You're welcome.

Mr. English.

MR. ENGLISH: I just want to say, thank

you, Mr. Vetne.

JUDGE CLIFTON: Now, let me hear from

somebody else besides Mr. Vetne on how important

1:00 Monday is to you. And I should have asked

Mr. Vetne, but I'll ask you if you come to the

podium, when do you anticipate we'll finish if

we start at 1:00 on Monday? By finish, I don't

mean just Monday. I mean the whole thing.

MR. BESHORE: I think --
MR. YALE: Go ahead.

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

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

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

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

The testimony from -- that I think is going to be next is from Braum's Dairy. I see a Charles Sharpe, a Tim Butler, a Sally Keefe, a Warren Taylor. Boyd, I don't know. There was a question mark. It wouldn't be this week, but it would come in next week, and this Dr. Orr and rebuttal. Now --
JUDGE CLIFTON: Tell me again. After Braum's, who was next?

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

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

MR. YALE: Tim Butler.

MR. RICCIARDI: Button.

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

JUDGE CLIFTON: After Button?

MR. YALE: Sally Keefe.

JUDGE CLIFTON: Okay.

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

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

JUDGE CLIFTON: All right.

MR. YALE: And maybe instead of 8:00 we
could do 9:00 or 10:00. But it looks like we're close unless somebody has some major epiphanies over the week and brings in boatloads of rebuttal evidence which will make all of us friends.

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

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

MR. ROWER: She's asked --

JUDGE CLIFTON: Into the -- sorry.

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

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

MR. ROWER: Okay.

JUDGE CLIFTON: She has a four-hour
drive. Maybe we shouldn't say what time we're going to start. Maybe that's not a good idea. Sorry. Let's just ask her to come Monday.

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

JUDGE CLIFTON: Mr. Miltner.

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

MR. BESHORE: Not tomorrow?

MR. MILTNER: No, not tomorrow.

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

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

Is there anything else before we proceed with testimony? If not, Mr. Bostwick may come to the witness stand.
THE WITNESS: Good morning, your Honor.

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

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

THE WITNESS: Yes, ma'am.

JUDGE CLIFTON: Please state and spell your name.

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

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

THE WITNESS: Very well.

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

(The witness was sworn.)

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

MR. RICCIARDI: Thank you, your Honor.
of lawful age, being duly sworn, was examined and testified as follows:

DIRECT EXAMINATION

BY MR. RICCIARDI:

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

A. I'm the chief executive officer.

Q. And how long have you held that position?


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

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

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

Q. And you get into the details in your statement, so I won't belabor it here. Just as an
introductory point, however, Braum’s operates as a producer-handler, is that correct?

A. Yes.

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


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

A. Yes, that’s correct.

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

A. As I understand it, yes.

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

A. Yes.

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

(Exhibit 87 was marked for identification.)

A. Yes.

Q. Okay. And do you have that statement in front of you, sir?
A.  I do.

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

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

    THE WITNESS: How about this?

    JUDGE CLIFTON: I think it'll work.

    THE WITNESS: Okay. Correct me if --

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

    THE WITNESS: Yes.

    JUDGE CLIFTON: And so --

    THE WITNESS: Oh.

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

    THE WITNESS: I see.

    JUDGE CLIFTON: Okay. Go ahead.

A. My name is W. Anthony Bostwick. I go by Tony. I am the chief executive officer of Braum's Ice Cream & Dairy Stores in Oklahoma City. Braum's Dairy is a vertically integrated, third generation company that's owned 100 percent by the Braum family, and there are four people named Braum.
We're in the Central Order. Braum's Dairy has operated as a producer-handler since 2001. Braum's sells all of its own dairy products in its own retail stores. It does not carry any other fluid milk brands. In addition to our farm and processing plants we have retail outlets in five states, Oklahoma, Texas, Arkansas, Kansas, and Missouri. These retail outlets contain three different business areas; a quick service restaurant with drive-thru windows, an ice cream parlor we call our fountain, and a fresh market where fresh dairy, bakery, meat, and produce items are sold.

Braum's is a member of the American Independent Dairy Alliance and supports denial of the petitions to change the existing status of producer-handlers.

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

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

Braum's has grown with our customer base during three generations of our existence. We milk approximately 12,000 cows, and our Class I utilization tends to be in the 50 plus range. Although we do not purchase or sell any raw milk, we do on occasion
purchase or sell condensed skim, nonfat dry milk or cream from other plants.

JUDGE CLIFTON: Let me stop you there. We all knew what you meant, but when you said that the utilization tends to be in the 50 plus range, was that 50 plus percentage range?

THE WITNESS: It would be 50 or more.

JUDGE CLIFTON: Percent?

THE WITNESS: Yes.

JUDGE CLIFTON: Thank you.

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

We do not view ourselves as the source of any disruption in the market in any way. We value the independence embodied in the producer-handler status because it fits our business as well. Our reputation with our customers depends on providing the consistent, fresh, high quality milk that they expect in the Braum's branded milk. Our milk is immediately chilled to 35 degrees Fahrenheit when it leaves the cow. It is delivered to our bottling plant within 8 hours, and is on the shelf in our stores within 36 hours. Our brand
is like a McDonald's type company in that our customer
expects a uniform, consistent product except in our case
they expect high quality as well. Braum's cannot depend
on pool milk to meet that standard. It is not uniform
quality with respect to freshness. And in short, based
on our quality profile, we cannot rely on pool milk.

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

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

We do not believe that is the case. A
lot has been said about the Central order in this
proceeding. The Central Order was greatly enlarged as a
result of Federal Order reform. It now includes many large cheese processing plants. In 2008, the Central Order data I received from our administrator showed that a very large volume of Class III milk was depooled, (removed from the pool) in each of 5 months when the value of Class III milk exceeded the blend.

In March of 2008, over 240 million pounds of Class III milk was depooled. In May 302 million pounds of Class III milk was depooled. In June of 2008, 246 million pounds of Class III milk was depooled. In October of 2008 over 185 million pounds of Class III milk was depooled, and in December, over 230 million pounds of Class III milk was depooled.

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

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

JUDGE CLIFTON: Or let's see.

THE WITNESS: It would be 185 million pounds.

JUDGE CLIFTON: Rather than 185,000?

THE WITNESS: Yes.

JUDGE CLIFTON: So I'm going to ask
Ms. Fisher to make that correction and have you initial it before you leave. So read the sentence again the way it should be.

THE WITNESS: Yes, ma'am.

JUDGE CLIFTON: Slowly, please.

THE WITNESS: Yes, ma'am.

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

THE WITNESS: Thank you, ma'am.

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

Second, we do not, as a producer-handler, have an unfair price advantage over regulated handlers. First, because we are independent, we get our milk at the cost of production on the farm, not the price the producer receives from the pool. And no one else is producing or selling our brand -- our branded milk
products. As evident from the description above, Braum's has a substantial investment in producing high quality milk.

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

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

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

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

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

JUDGE CLIFTON: I'm sorry. Start that
sentence again, please.

A. While Class I fluid producers --

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

THE WITNESS: It actually is --

JUDGE CLIFTON: Producers?

THE WITNESS: -- processors. It is.

It's proper. It's processors.

JUDGE CLIFTON: Oh, all right.

THE WITNESS: I read it incorrectly.

JUDGE CLIFTON: Read it from the beginning.

THE WITNESS: Yes, ma'am.

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

I would also like to point out that to the extent its utilization matches the pool, a producer-handler has no affect whatsoever on blend price. Braum's is an example of this type of
producer-handler. If we were required to participate in
the pool, a very likely result could be an increase in
the blend price rather than an increase due to our
utilization of Class III milk, precisely the opposite
intent of the NMPF and the IDFA proposals.

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

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

MR. RICCIARDI: Thank you, your Honor.

Just a few matters that I want to amplify from
the statement before I move the admission of the
exhibit and have Mr. Bostwick be questioned by
other people in the room.

BY MR. RICCIARDI:

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

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

Q. And it was started by the Braums family?

A. Yes.

Q. And in the '30s what type of operation
was it?
A. It was originally a butter wholesaler -- manufacturer and wholesaler. And then it morphed into an ice cream business.

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

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

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

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

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

A. Okay. In the fresh market you can find our full line of dairy products, chocolate milk, orange
juice, bottled water, stack solids, ground beef in both
a modified atmosphere package and Chub. Find fresh
apples, oranges, bananas, strawberries, grapes,
potatoes, onions, really about anything that you would
expect to see in a fresh market or a farmer's market or
that part of the grocery store.

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

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

Q. So -- and all of the products that
Braum's sells are retailed at its own outlets?
A. Yes. We don't -- there are no Braum's
branding anywhere other than in a Braum's store, and we
do no manufacturing for anyone other than ourselves.

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

Q. One other point that I do want to talk
about with you for a moment before I move the
introduction of the statement. You said that as part of being a producer-handler, that you are responsible for producing all of the milk you use in the bottling plant and bear the responsibility for managing the surplus. How does Braum's Dairy handle its milk production? How does it use it?

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

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

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

A. Yes.

MR. RICCIARDI: Okay. Your Honor, I would move at this point the admission of Exhibit 87 and sit down until redirect.
JUDGE CLIFTON: Thank you, Mr. Ricciardi.
Is there any objection to the admission into
evidence of Exhibit 8-7, 87? There is none.
Exhibit 87 is hereby admitted into evidence.
Who will begin cross-examination of
Mr. Bostwick? Mr. English. Thank you.

CROSS-EXAMINATION

BY MR. ENGLISH:

Q. Good morning, sir. My name is Charles
English.
A. Good morning.
Q. I represent a coalition of fluid
processors and trade associations of fluid processors,
largely subject to the pricing and pooling provisions of
the Federal Orders. I'd like to start by asking -- I
don't have a lot of questions.

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

A. No. There are a few items that are not
under the Braum's label. In the fresh market, for
example, our bag salads are Fresh Express. And we have
some cheese product that are manufactured by Belle
(phonetic) and their name is on that product. So not
everything is private labeled. But everything that we
make is Braum's labeled.
Q. Okay. And I apologize. I should have been crisper with my question. It's a little early in the morning, and we've been going a long time. How about your fluid milk products, are they all sold under the Braum's label?

A. Absolutely.

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

A. Yes.

Q. Okay. And who is Drew Braum?

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

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

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

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

A. That would be true.

Q. Who is Mr. DePee?

A. Mr. Who?

Q. Mr. DePee.

A. Al DePee?
Q. Yes.
A. He was our director of manufacturing.

He's since retired.

Q. Is his name spelled capital D, e, capital P, e-e?
A. Yes.

Q. That's for the court reporter --
A. Okay.

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

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

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

JUDGE CLIFTON: Thank you, Mr. English.

Who will next cross-examine Mr. Bostwick?

Mr. Vetne.

CROSS-EXAMINATION
BY MR. VETNE:

Q. Good morning, Mr. Bostwick.
A. Good morning, sir.
Q. I'm John Vetne. I'm an attorney from New Hampshire. My clients are producer-handlers in the Pacific Northwest and in Arizona -- or, I'm sorry, New Mexico.

You -- I'll try to go through in order here. Your plant is located in Oklahoma, which is part of the Central marketing area?
A. Yes, sir.
Q. And you have distribution into Texas, which is the Southwest marketing area?
A. Yes.
Q. And you have distribution into Missouri, parts of which are located in the Southeast marketing area, correct?
A. I don't know.
Q. You don't know. Okay. Do you believe that if -- if you were fully regulated, you would be -- be fully regulated as a pool plant in the Central marketing area as opposed to some other marketing area?
A. I really don't have any idea.
Q. Would a -- would a plurality of your fluid milk be in Oklahoma and Kansas?
A. It would be close to 50 percent --
Q. Okay.
A. -- I would think.
Q. I'm intrigued about your low fat -- lower fat milk products. You remove water. Is that a reverse osmosis process?
A. No, it's actually a -- it's -- we use a vacuum pan and actually remove the water through a low boil. When you take a liquid and put it under a vacuum, it'll boil at a lower temperature. So you are able to remove water at a very low temperature, the same method as you would if you were boiling water or boiling milk. You can remove the water. But it's a vacuum pan process.

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

Q. It's the kind of process that Emeril, the chef on TV, would refer to as reduction?
A. I don't know.
Q. You don't know?
A. No.

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

MR. VETNE: E-m-e-r-i-l. I've got to be
careful what I refer to. I don't want to get caught on the spelling error. I've done that once.

BY MR. VETNE:

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

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

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

A. Yes.

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

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

Q. So you show how you use your milk?

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

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

A. It wouldn't have any milk solids.
It's -- it's distilled water.

Q. Yes.

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

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

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

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

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

A. Oh, absolutely.

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

A. Yes. As a matter of fact, we do a lot of
encouraging of people to test our fat free milk against
grocery store milk, and I point out that there's
50 percent more calcium.

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

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

A. Yes.

Q. -- rather than low fat, right?

A. Yes, yes.

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

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

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

A. Yes. The only thing -- the only thing
that's not what you would expect, I guess, in a 2 percent, 1 percent, it would be the nonfat solids. Everything else would be what you would expect.

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

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

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

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

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

A. Well, again, as we said, my Class I utilization tends to be fairly flat. But my
manufacturing -- excuse me, my -- my production from the
cows is not. So it would probably be a little
misleading for me to say that my -- my utilization
varies because of my -- my sales. It varies because of
my milk that I need to process through my plant.

Q. I understand that absolutely clearly.
A. Okay.

Q. So my question is, your Class I use as a
percent of production on a monthly basis during the
course of the year will ordinarily range from X percent
to X percent, understanding that your Class I volume is
relatively flat. Is there a ballpark range, Class I --
A. There's not one I'd really like to share.
Q. You, on occasion, purchase or sell
condensed skim nonfat dry milk or cream. First of all,
condensed skim --
A. There should be a comma there.
Q. There should be a comma. There's no
product called condensed skim nonfat dry milk. Or,
actually, there may be --
A. I think there is. But it's redundant.
Q. Let's see here. Okay. Do you make
condensed skim that you sell?
A. No, not that we -- retail?
Q. Does your plant, from your farm milk?
A. Oh, I see. No. It's easier to transport if you go ahead and condense it. You can get a lot more in a tanker if you remove water before you sell it.

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

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

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

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

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

A. Yes.

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

A. Yes, we have a typical tanker truck, 6,000 gallon. And we have a 12,000 that's -- that's too
large for the road that we use on the farm to move the
milk from the -- from the milking barn to -- to the
plant.

Q. To what type of milk plant customer do
you market condensed skim when you make condensed skim?
A. Again, I'm not sure that I market it;
what I call in desperation trying to find somebody to
take it. It's typically a Class II plant.

Q. Do you know whether the Class II plants
to which you typically sell your condensed skim milk are
or are not categorized as pool plants?
A. My guess, that they would not be pool
plants.

Q. Okay. Are those Class II manufacturing
plants all located pretty close to yours or are they in
a variety of geographic areas?
A. You know, I don't know the answer to
that.

Q. Do you know whether your condensed skim,
when you sell it, it goes north as well as south, east
as well as west?
A. I think most of it is close. Whether or
not it's -- how close or which direction, I -- I don't
know.

Q. Okay. With respect to nonfat dry milk,
does Braum's dry and powder its own milk?
A. No, actually, and I -- I don't.
Occasionally, I will buy some of that.
Q. Okay. So the sentence referring to
purchase or sell with respect to nonfat dry milk, you do
not make and sell your own nonfat dry milk?
A. Right. It's I make and sell or I buy and
sell these -- these items, not necessarily buy all of
them and sell all of them.
Q. Do you sell nonfat dry milk?
A. No.
Q. The purchase and sale clause preceding
all of these, nonfat dry milk is the only one that you
do not sell? You purchase or sell condensed skim and
you purchase or sell cream?
A. Over a long period of time that would be
true. I'm trying to remember the last time we bought
cream. I have bought cream, so -- but it's probably
been years.
Q. Cream is something, however, that you do
produce in your system from your own milk, and you have
the opportunity to sell if you have excess?
A. Well, generally I use all my cream.
Q. I understand.
A. Okay.
Q. But you make cream, and if somebody wanted it and paid enough, you would -- at least it would be available to sell?
A. Retail?
Q. No, bulk.
A. No. I can't imagine that -- unless I just happen to make a mistake and end up with too much cream, I wouldn't sell cream. I would -- I would make ice cream with it.

Q. All right. On page 2 you talk about depooling, and I think you're the first witness that has referred to the nonpooling of producer-handler Class I milk as depooling.
A. Well, that probably comes from my lack of experience with the terminology that most of you know better than I do. So I appreciate the schooling on that. That may not be appropriate.

Q. I understand what you meant there. With respect to your producer-handler Class I milk, you intended the word, depooling, to mean milk that is not included in the pool?
A. Yes.
Q. You did not intend with respect to your producer-handler Class I milk to mean milk that goes in the pool and comes out of the pool on a monthly basis
depending on arbitrage opportunities?

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

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

A. As I understand it.

Q. As you have learned since January?

A. Yes.

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

JUDGE CLIFTON: Comma, is that correct?

Was that a question? Or --

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

JUDGE CLIFTON: Okay. All right.

BY MR. VETNE:

Q. My question there is, as a handler, you're receiving milk at whatever your farm segment of
your operation costs, but other -- well, let me start there. The cost to your plant enterprise for milk is the cost that your farm enterprise produces milk for?

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

Q. Let me stop you right there --

A. Okay.

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

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

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

Q. The farm operation?

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

Q. And then the retail overhead in your stores?
A. Yes, that's true.

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

Q. To the extent that there are processing handlers that want to compare -- fully regulated processing handlers that want to compare their risks and operations and costs with yours, one of the risks that your operations has in its enterprise is all of the risks at the farm level. A processor that only buys milk does not have farm level risk, is that correct? It just has a price that it pays?
A. Well, I believe that -- that's true.

Handlers have risks that farmers don't have. And farmers have risks that handlers don't have. So they both have risk. A producer-handler has all the risks. And I have the retail risk.

Q. At the top of the last page you refer to you estimate that full regulation would add an annual regulatory cost, you inserted, of $300,000 to our
business, simply for administrative oversight by the
Market Administrator. That $300,000 is a reference to
what charge by the Market Administrator? Would that be
the administrative order assessment of a nickel?
A. And the 6 cent fee.
Q. Okay. So there would be a nickel charged
per hundredweight that you are not now paying --
A. Right.
Q. -- to administer the order to, among
other things, audit your books and records, which is a
big part of administration, to make sure that Braum's
plant is paying the right amount of money to the Braum's
farm?
A. That's correct.
Q. Okay. And there's another assessment
called marketing services --
A. Yes.
Q. -- which is charged for independent milk.
Processors that receive independent milk are charged so
that the Market Administrator is reimbursed for the
costs of comparing tests to make sure that the producer
is paid for the right test, and that the components are
properly tested, is that --
A. And my understanding is I would be
subject to both of those.
Q. So you would be charged as a handler for the service of making sure that you, as a producer, are paid on the right tests and components?

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

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

A. Again, as I understand it.

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

A. As I understand it.

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

THE WITNESS: Thank you, sir.

JUDGE CLIFTON: Thank you, Mr. Vetne.

Mr. Beshore.

CROSS-EXAMINATION

BY MR. BESHORE:

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

A. Good morning, sir.

Q. I have just a couple of questions for
you. Your statement in 87, you say at the very beginning that you have been a producer-handler since 2001?

A. Yes.

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

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

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

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

Q. Okay.

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

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

A. Yes, sir.

Q. And you say you are the CEO of Braum's
Ice Cream & Dairy Stores, which you don't identify as a corporation or an LLC. Is that a corporation? Is that the corporate name?
   A. It's a d/b/a, kind of the family business.
Q. Okay. So what is the legal entity for which you are the CEO?
   A. Actually, the legal entity is Braum's, Inc.
Q. Okay. And what operations are within the corporate operations of Braum's, Inc.?
   A. The retail operations.
Q. Okay. How about the plant operations?
   A. The plant operations are in W. H. Braum, Inc.
Q. So there's a separate corporation called W. H. Braum, Inc.?
   A. Right. It's an affiliated. They're all owned the same percentages by the same people. Because we're an S corporation it's difficult to have a holding company. So the corporations are owned by the same four people.
Q. And then what about the farm operations?
   A. It's actually in another S corporation called Whb Company.
Q. Who is the Company?
A. Yes.
Q. Okay. Now, do you as CEO — are you CEO over the total complex?
A. Under the umbrella of Braum's Ice Cream Stores Inc. umbrella, but —
Q. Is the umbrella for all those various S corporations?
A. Yes, and LLC and LPs and on it goes.
Q. Okay. And how many separate business entities are there that you — in the family of companies that you are the CEO for?
A. Well, it might seem larger than it really is. There are seven. One is a grain supply company that operates a couple of retail grain elevators and that type of thing to support the local communities. There's a transportation company that's in a separate company. And there's an intellectual property company that owns trademarks and licenses and that type of thing. There's a real estate holding company that owns real estate. So it's a more complicated than it probably needs to be.
Q. Now, I noted on your — just pursuing your website a little bit that you have approximately 275 retail stores?
A. Yes, sir.

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

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

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

A. Sure.

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

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

JUDGE CLIFTON: Mr. Ricciardi.

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

So two things. I think it's confidential, number one. Number two, I think
it's irrelevant for the proceeding.

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

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

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

MR. RICCIARDI: It's both.

JUDGE CLIFTON: It's both?

MR. RICCIARDI: (Nodding head.)

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

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

JUDGE CLIFTON: Well, no, you asked --

MR. BESHORE: I think that's
self-evidently relevant.

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

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

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

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

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

MR. VETNE: Your Honor, I absolutely agree with Mr. Beshore and disagree with Mr. Ricciardi. As you will recall, the clients that I represent put on testimony and put on a
lot of detail about their business of the kind for which others have raised confidential questions. The confidentiality or proprietary information is not -- is not in and of itself a recognized legal objection. A witness can disclose as much as he or she wishes about their company. How much he or she discloses adds to credibility, subtracts from credibility, reliability or nonreliability of the conclusions.

The how it's invoiced is -- is -- you know, is not a question to ask what the price is. And if we are going to get -- if a witness such as this -- unfortunately, the less disclosed about the transaction, the less the Secretary has to work with, the less the Secretary has to test the credibility of assertions of the proponent in the first instance on competitive disadvantage of producer-handlers. And on the opponent side, oh, we don't -- we're not a problem. You can't judge either unless you have some of the core data, and without the core data all you have are conclusions, and conclusions is not substantial record evidence.
So I think -- I think the question was
good. I don't think that the objection is
well-founded. I do think that the witness,
because we don't have a compulsory process, can
refuse to answer any question. And when a
witness refuses to answer questions, that
witness' credibility is reduced. That's it.

JUDGE CLIFTON: Mr. English.

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

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

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

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

MR. BESHORE: No.
JUDGE CLIFTON: All right. It's perfectly legitimate for everyone in the room to want to know the financial workings. It is also acceptable if you do not want to disclose it. I agree with Mr. Vetne, the more that it is disclosed, the more everyone can get a handle on whether the privilege of not paying into the pool in Braum's case is disruptive.

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

THE WITNESS: (Nodding head.)

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

Mr. Beshore, you may ask your next question.

BY MR. BESHORE:

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

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

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

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

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

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

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

Q. Okay. And are there any reference points
of which you're aware?

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

Q. Does it vary --

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

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

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

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

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

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

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

A. -- he -- it's based on what he thinks it should be. I wished I had more visibility into -- he's a brilliant man. I wished I had more visibility into
how he actually comes up with some of the numbers, but I
don't.

Q. Do you actually run P&Ls --
A. Yes.

Q. -- for the separate corporations?
A. Oh, yes.

Q. And they're based on the transfer price
in and out?
A. Right. Again, since they're S corps, all
the -- all the revenue flows up with the shareholders,
unlike a C corp that would be taxed at that corporate
level. That's why it doesn't matter what those are.

Q. Since it doesn't matter -- ultimately
matter for tax purposes?
A. No, it doesn't because they -- as I said
before, it's like partners. If you had a loss in a
partnership and a gain in this partnership, they both
flow up to the shareholder or the partnership. And it
wouldn't make a difference which one of those had the
gain and which one had the loss.

Q. The transfer prices are important,
however, for internal management purposes in terms of
evaluating how the separate operating entities are
operating?
A. Yes, based on how -- the measuring stick
Mr. Braum's wishes to apply.

Q. Right. Okay. Typically with the measuring sticks he applies are you profitable at each level?
A. Not always.

Q. The $300,000 estimated cost, if I understood your responses to Mr. Vetne, that was based on the assumption that Braum's would have to pay a 5 cent administration fee and a 6 cent nonmember milk fee per hundredweight? Is that your understanding?
A. That's my understanding. And again, I -- that's my understanding, yes, sir.

Q. And that figure was provided to you by whom?
A. That -- the Central Administrator.

MR. BESHORE: Thank you.

JUDGE CLIFTON: Just so I'm clear, that's the Central Order Market Administrator gave you that number?
THE WITNESS: Yes.

JUDGE CLIFTON: Based on the reports that you had been filing or did you give the Market Administrator some figures to work with to calculate that for you?
THE WITNESS: No, no. He has all of our
numbers on a monthly basis.

MR. BESHORE: Thank you very much,

Mr. Bostwick.

JUDGE CLIFTON: Thank you, Mr. Beshore.

Is there any other cross-examination of this

witness? Mr. Carroll.

CROSS-EXAMINATION

BY MR. CARROLL:

Q. Good morning, sir.
A. Good morning, sir. How are you?
Q. Fine, thank you.
A. Good.
Q. I'm John Benjamin Carroll. I represent

the New England Milk Producers Association and two

additional producer-handlers in Order Number 1. They

live in Vermont and in Connecticut.
A. Oh, pleased to meet you.
Q. And some of them have been in business

even longer than you.
A. Oh, my.
Q. First of all, before I ask you any

questions, I want to join with the others who have

complimented you on this statement. It's short, it's to

the point, there are bullet points, and I think you've

managed to come to the heart of the issues that are
involved in this proceeding. And that's why I consider
you a very important witness.

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

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

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

When you have the ability to do that,
then you have much more opportunity to be pool neutral.
As in my case, I make a lot of ice cream. If I were to
be something other than pool neutral, I would probably
have the ability to -- to get pool neutral. Because
I've got a diversified offering. And the larger
companies and cooperatives are similarly situated, I
believe.

Q. Is it practical for the small processor, producer-handler processor, to engage in that kind of balancing activity, or is he pretty much confined to the Class I market because of his size?
A. You know, I don't know the answer to that. All I do know is it's a lot easier for me because I'm a retailer.

Q. Now, directing your attention to the next sentence, it says, while Class I fluid processors in the regulated pool are required to pay into the pool, Class III manufacturers withdraw from the pool. Could you explain that sentence?
A. I can't explain the reason why. It doesn't make any sense to me. Milk -- but -- but, as I understand it, of course, Class I prices generally, though not always, but are generally higher than Class III. And Class I is generally higher than blend where Class III is generally lower than blend, although not always.

And so generally speaking, if you are a Class I utilizer, you will pay a higher price than the
blend. And that's the way I understand it, is really the -- the heart of what the pool is, is the blend.

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

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

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

Q. Milk costs less?

A. Yeah.

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

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

JUDGE CLIFTON: Thank you.

BY MR. CARROLL:

Q. Now, the next sentence you stated: This is an advantage of scale and diversification that is not
available to most independent producer-handlers and to
us illustrates why producer-handlers cannot, as a
factual matter, be responsible for creating any
disruption in the national marketplace. Could you
explain that sentence?

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

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

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

Could you explain to me that sentence?

A. Yes. The way I understand it is if a
handler's utilization is the same as the -- the pool or
the blend utilization or the utilization that produces
the blend, then the handler's utilization cost or his
cost of milk based on the various prices, blend prices,
would result in a blend price.

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

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

A. 50 plus.

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

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

Q. And what effect, if any, would that have
on the blend, according to your statement?

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

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

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

   A. It certainly can.

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

   A. I'm not sure I understand.

   Q. All right. Well, let me withdraw that.

At any rate, you know there are manufactured dairy
products, and you are engaged in some manufacturing
yourself?

A. Oh, certainly.

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

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

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

A. Can you make money in the handler
business?

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

A. I believe so.

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

A. I'm not sure I understand.

Q. Well, let's say you have the alternative
in front of you for a moment, hypothetically. You have
a hypothetical alternative. You have milk you could put
into, let's say, ice cream or into some other similar
product that requires some manufacturing.
A. Well, but ice cream, I consider that requiring manufacturing, so I guess that's why I'm getting stuck here a little bit.

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

A. Yes.

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

A. Oh, sure.

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

A. Yes.

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

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

CROSS-EXAMINATION

BY MR. YALE:

Q. Good morning.

A. Good morning.

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

Mr. Bostwick, you talked about an innovative product or processes to produce this higher
solids milk with lower fat. Does the producer-handler model that you have, that is, that you use your own milk, you don't buy it, you use your own milk and bottle it, does that contribute to the innovation and the ability to be innovative in this process?

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

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

A. Okay.

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

A. In California it is.

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

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

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

A. Okay.

Q. And I think your protein is probably protein, 5, 6 percent. Do you know?
A. I do not.

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

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

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

A. Yes.

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

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

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

A. I believe it would have, yes.

Q. Well, all right, let me take it a different way. You don't pay minimum prices under the Federal Order, right?
A. Oh, right, I do not today.

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

A. That's --

Q. You looked at your costs?

A. I looked at my costs, yes.

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

A. No.

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

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

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

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

Q. Okay. Now, the -- there was some
discussion on transfer costs, intercompany. There's
been a lot of talk throughout this hearing that
producers -- producer-handlers, I mean, somehow you can
break it down and say they got a uniform price as a
farmer, and then they have an obligation to pay this for
their milk.

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

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

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

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

Q. But in the end, it ends up with the same
bottom line for your stockholders, right, regardless --
A. Exactly. And the tax returns look the
same. Everything is the same. It doesn't make any
difference. That's why it's a -- I don't get the
argument, frankly. It's my costs. That's what it costs
me. Anything else is -- to me, is a dishonest way of
looking at it.

Q. I want to move to another topic just to kind of follow up on some questions on utilization. You talk about your administrative cost. Was there any analysis done that if you had been regulated over a period of a year, two years, three years on a month-to-month basis, what the individual obligation or draws would be into the pool?

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

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

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

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

A. You know, I don't.

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

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

A. Thank you, sir.

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

A. Yes, sir.

Q. You didn't bring any with you?

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

JUDGE CLIFTON: Mr. Beshore.

RE CROSS-EXAMINATION

BY MR. BESHORE:

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

A. Yes, I believe I am.

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

A. Big dairies, that's right.

Q. Big dairies. Okay. And their price goes up -- when the regulated minimum price goes up, their
1. price goes up and when the regulated minimum price goes
down, their price goes down, and you follow?
2. A. That's right.
3. JUDGE CLIFTON: Mr. Vetne.
4. RECCROSS-EXAMINATION
5. BY MR. VETNE:
6. Q. Okay. I need to follow up on that,
7. Mr. Bostwick. When you referred to the price that you
8. follow, you were referring to the competitive price or
9. the consumer price at the grocery store shelf in other
10. retailers, correct?
11. A. Yes.
12. Q. You were intending to, as Mr. Beshore
13. suggested, follow the price charged by other processors
14. to -- as a wholesale price to those retailers?
15. A. Oh, yeah. I apologize. When I think of
16. price, I think of retail prices. Those other prices
17. don't mean anything to me.
18. Q. You don't follow them. You don't know
19. what they are?
20. A. Well, I started following them in
22. Q. How do you follow them? How do you know
23. what other processors are paying -- are charging their
24. wholesale customers?
A. I don't know that. What I do know --
yeah, I don't know that at all. I know what the class
prices have been and what the blends has been, and I
certainly know in Kroger's in McKinney, Texas, there's a
70 cent difference between their Kroger store brand and
their other brand. And I don't understand how they can
do that, but -- but they are. And they both are coming
out of the same plant. So I don't understand all of
that from a pricing standpoint. All I know is, is
that's what the consumer knows, and so that's what I'm
compared to.

Q. Actually, an 80 cent difference.

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

MR. VETNE: Okay. Thank you.

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

THE WITNESS: It's a city.

JUDGE CLIFTON: Oh.

THE WITNESS: It's north of Dallas.
McKinney, Texas.

JUDGE CLIFTON: Okay. Spelled M --

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

JUDGE CLIFTON: Okay.

THE WITNESS: Beautiful city.

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

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

JUDGE CLIFTON: Decades?

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

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

CROSS-EXAMINATION

BY MR. TOSI:

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

A. Certainly.

Q. I'd like to ask, your appearance here today, are you testifying on behalf of just Braum's or is your testimony also -- you know, besides saying that you are supporting the proposals that have been offered by AIDA, are you testifying on behalf of AIDA or just for Braum's?
A. I believe I'm just testifying for Braum's, as far as I know.

Q. Okay.

A. That's really my interest.

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

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

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

A. That's a fair question.

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

A. It actually doesn't always lower it.

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

A. My understanding is that depooling occurs when there's an inversion to the status quo. In other words, that generally the Class III price is less than
blend, and so a Class III utilizer can purchase that Class III milk -- excuse me -- yeah, Class III milk, that's right, at a lower price. And when that price becomes higher than blend, and in some cases even exceeds Class I price, they don't have to pay that price.

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

Q. Okay. And with respect to depooling, are you aware that the marketing orders have a set of pooling standards contained in the orders?
A. No.

Q. Okay. Do you know if an order contains provisions that says, for example, how much milk a producer has to ship to a distributing plant in order to be pooled on the order --
A. No.

Q. Okay. But you do seem to understand that when milk gets depooled, that there could be a negative impact on the blend price? That part you seem to understand pretty well.
A. Yes. Initially I thought that -- that -- when I was looking at the -- I think they're called producer receipts. I couldn't figure out why they fluctuated so much from month-to-month, because no one's production could do that, but yet it was called producer receipts. And so I was like, well, what is that?

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

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

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

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

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

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

A. I do not.
Q. Would you characterize it, at least in the Central market, that it's cooperatives that largely do that?

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

Q. Okay.

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

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

A. I have no idea.

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

A. Yes.

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

A. Yes.

Q. That's an impressive number. How -- how was it that you came up with $300,000?
A. Well, the number wasn't exactly 300, but it was -- it was close to 300. So it was in that 300 range. And we actually got that from the Central Order. They gave me that number.

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

A. Yes.

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

A. Yes.

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

THE WITNESS: Thank you, sir.

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

THE WITNESS: I hope it helped.

MR. TOSI: Thank you.

JUDGE CLIFTON: Mr. Ricciardi, any redirect?

MR. RICCIARDI: Thank you, your Honor.

REDIRECT EXAMINATION

BY MR. RICCIARDI:

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

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

A. Yes.

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

A. Yes.

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

A. Yes.

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

A. Yes.

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

A. Yes.

Q. A question was also asked of you about essentially what happens if, I guess, the elimination proposals actually get adopted in some fashion by the
Department. Do you know at that point, because we don't
know, in fact, what proposals will be adopted, how
Braum's would have to adapt to those changing
regulations?

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

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

A. Yes, I do.

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

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

Q. Okay. And the $300,000 is an admin
service fee, it does not take into consideration what
the pool impact for a pool payment would be if the
producer-handler exemption were eliminated, right?
A. Right, right. And there's no way for me to know what that could possibly be because it moves.

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

A. Yes.

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

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

Q. I understand. I want to clarify one more point, I think, so that it is clear in this record. In terms of looking at pricing for fluid milk products, certainly at least before January, February of this year, you weren't looking at what the Class I price was, the blend price or anything like that in terms of what
you were doing with your retail operation, were you?
   A. No.
   Q. You were just trying to look around and see what the consumer prices in general were in your area?
   A. Specifically within a three-mile radius of each one of my stores.

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

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

THE WITNESS: Thank you for your help.

JUDGE CLIFTON: Do initial the changes before you leave.

THE WITNESS: Thank you.

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

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

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

(Exhibit 88 was marked for}
THE WITNESS: My name is Sally Keefe, S-a-l-l-y, K-e-e-f-e.

JUDGE CLIFTON: Thank you. If you'll raise your right hand, I'll swear you in.
(The witness was sworn.)

JUDGE CLIFTON: Thank you.

Mr. Ricciardi.

MR. RICCIARDI: Good morning, your Honor.

SALLY KEEFE of lawful age, being duly sworn, was examined and testified as follows:

DIRECT EXAMINATION

BY MR. RICCIARDI:

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

A. Good morning. I'm fine.

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

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

JUDGE CLIFTON: Your voice is soft.

THE WITNESS: Okay.
JUDGE CLIFTON: So a little closer to the
mic, please.

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

A. Yes.

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

A. Yes.

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

A. I do.

Q. Would you proceed with the statement,
please?

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

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

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

Our goal when we started was to develop the market for private-label organic milk. We had identified this market segment as being underserved. To do this, we needed both reliable organic milk supply and processing. Most organic milk was and still is processed under co-packing arrangements. This creates a situation where organic competes for line time, attention, et cetera, with everything else that the co-packer is making. So we decided to build a dedicated processing plant for our own milk. In 2004 we opened our state-of-the-art processing plant. Our total
investment in the plant was over 35 million.

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

Milk balancing is what we have to do when the supply and demand for our milk do not line up. Suggesting that we are somehow incapable of balancing our own supply because of our status as a producer-handler is nonsensical. It is always the case
that our customers have alternative suppliers, as well as product options and a variety of size formats. Such choices include beverages other than fluid milk; for example, fortified juice and soy drinks.

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

We do not produce anything other than certified organic milk. As a result, our cost of production is considerably higher relative to conventional producers. Because only milk that has been produced and certified in accordance with the requirements of the Organic Foods Production Act and the National Organic Program regulations is entitled to be called organic and labeled with the USDA organic seal, our milk is simply not interchangeable with conventional milk. We cannot purchase conventional milk from pool
producers and sell it as organic. We can only use certified organic milk.

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

We are not similarly situated to others in the organic marketplace because we have invested in both organic dairy farming and processing and bear the full risk and responsibilities of both. Dairy farming is a biological process and inherently uncertain. It is risky for a number of reasons, including (among other things) the uncertainty of calving schedules, the threat of disease, ever-changing commodity costs and the impacts of weather. Likewise, processing has its
attendant risks, among which include equipment and packaging failures and variability of customers' orders, not to mention the large investment required up front to build the plant in the first place. A producer-handler incurs all of this risk and must also develop and sustain markets for its products.

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

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

The benefits of being vertically integrated include providing traceability and complete control of our organic milk. The fact that we process
all of our organic milk ourselves is very important to our customers, because as a result, our customers know the source of all of the milk and also know that it was processed in a plant that is dedicated to organic. A lot of processing plants do both organic and conventional milk, for example, on alternative shifts, and it gives our customers a great deal of comfort knowing that their milk could not have possibly been commingled with conventional milk.

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

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

A national account customer hired us for a secondary supply role after being initially supplied by a national brand vendor. Our service levels continuously exceeded those of the national brand. This, in turn, made it clear to the customer that the branded supplier simply did not value the customer's
business the way we did. We were awarded additional
roles with the customer, even at higher prices than the
other vendor, until all the business was awarded to us.

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

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

The effects on Aurora if Proposals 1, 2
or 26 are adopted by USDA would be dramatic and
potentially devastating. It is overly simplistic to
conclude that because Aurora Organic Dairy is a producer-handler that we have a price advantage, much less a price advantage that would create any disruption in the market. Unlike organic producers who do not process their own milk, we have invested millions of dollars in a dedicated processing plant. And unlike handlers who do not produce organic milk, we have invested millions of dollars into our farming operations. We have also incurred the attendant risk of balancing ourselves, which as previously indicated is no small risk given that we have to find our own markets and outlets for our supply.

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

We support the existing regulatory provisions and we do not want to see any changes. In our view, it is not possible to determine the presence
or absence of orderly marketing conditions without considering the actual prices being paid to producers and the actual costs incurred by handlers for the milk they buy. Based on the actual prices and costs in our market, we do not observe any unfair competition or the creation of any disruption in the marketplace as a result of producer-handlers.

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

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

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

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

JUDGE CLIFTON: Thank you, Ms. Keefe.

Mr. Ricciardi.

BY MR. RICCIARDI:

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

The first one is on page 4 under the
heading, How We Compete, the second sentence -- third
sentence, I apologize. You added the word, after been
and before on, the word dragged: As someone who has
been dragged on sales calls. Did you intend to do that?

A. That was probably a Freudian slip.

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

A. Not that particular word, thank you.

Q. Okay. I can understand the issue.

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

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

A. Yes.

Q. Okay.

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

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

MR. RICCIARDI: Okay. So the full sentence would read then, your Honor: This, in
turn, made it clear to the customer that the branded supplier simply did not value the customer's private label business the way we did.

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

BY MR. RICCIARDI:

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

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

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

A. I misspoke. It should -- the word should
have been market.

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

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

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

BY MR. RICCIARDI:

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

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

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

Q. So that Aurora was selling in that case at a price that was actually higher than the
nonproducer-handler vendor, is that your testimony?

A. Yes.

Q. Okay.

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

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

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

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

CROSS-EXAMINATION

BY MR. VETNE:

Q. Good morning, Ms. Keefe.

A. Good morning.

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

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

A. No.
Q. Okay. You have no prior witness experience in a Federal Order proceeding?

A. Definitely not.

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

A. Okay.

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

A. Yes.

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

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

Q. Okay. In 1996, what were you doing that caused you to start becoming familiar with Federal Milk Marketing Orders?
A. I worked in an operations department of another organic dairy company, and we were -- at the time the company did not understand the charges that were coming through from the co-packer regarding pooling. And I was asked to try to figure it out.

Q. And who was your employer at that time?
A. My employer at that time was Horizon Organic Dairy.

Q. Aurora Organic makes from its own-farm milk, fluid milk products, butter and nonfat dry milk?
A. That's correct.

Q. Does Aurora Organic make any other dairy products?
A. No, the only other dairy products that we market are bulk milk, items certified organic or occasionally conventional.

Q. Aurora Organic packages no cream or half and half?
A. We do not currently package any cream or half and half.

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

Q. And that is the milking portion of your
herds?

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

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

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

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

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

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

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

Q. That would be an average over the course of months?
A. Uh-huh. It would be an average over the course of years.

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

Q. By the way, when you make butter, is that sold in bulk, too, or do you package and label and sell?
A. The vast majority of the butter that we sell is private label or store brand organic butter. We do do some bulk, what we think of as ingredient sales of organic butter, but that is more limited.

Q. And the powder, is that packaged in consumer packages and sold to stores?
A. No, the powder is packaged as a -- the powder is packaged in 50 pound bags. It's an ingredient. It's not very consumer friendly.

Q. It's sold to manufacturers that use it as an ingredient in other organic -- in other products that they can advertise as organic?
A. Yes, that's correct. Our -- our certified organic nonfat dry milk powder is a
100 percent organic ingredient. The organic regulations are very specific regarding whether the -- the labeling claims that you can make with respect to organic are very specific regarding the ingredients in your product. So our powder is a 100 percent organic ingredient.

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

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

Q. Do you ever sell cream in bulk?

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

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

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

Q. One of the balancing activities in which you engage, you identify as farm production; we balance
our milk by farm production. So describe the farm production part of that activity.

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

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

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

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

A. So --

Q. Let me tell you what my understanding is. A milking cow has a finite milking cycle, a period where you stop milking the cow and impregnant the cow, produce a calf and get another milking cycle. Am I correct?
A. Yes, hopefully she's pregnant before you dry her off.

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

A. Uh-huh.

Q. Is that correct?

A. Yes.

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

A. Yes, it does.

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

A. That would be correct.

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

A. Yes. If we were short of milk, the inverse would be that we might not cull an open cow at, you know, 305, 400 days of milk, something like that, that we would continue milking her if we were short, and then that culling decision would be pushed into the future.
Q. And because of the declining production at the end of the milking cycle, that volume costs a bit more to produce?

A. Yes, indeed.

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

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

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

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

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

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

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

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

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

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

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

When -- when you change the ration, you have to be very cautious that you don't introduce long-term problems into the herd that could -- that
could damage the productivity of your cow in the
future -- the herd in the future.

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

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

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

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

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

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

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

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

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

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

A. Uh-huh.

Q. And there are also different ways on the
cost of production calculation to account for -- for
debt and payments on debt.
   A. Yeah.
   Q. The -- the principal part of -- a
principal interest payment to a lender ordinarily is not
included in cash costs -- I'll represent that to you --
but instead comes under a different heading called
depreciation.
   A. Uh-huh.
   Q. The interest costs are an expense, but
the cost of the asset is reflected in depreciation.
With respect to that scenario, how -- where is de --
depreciation, if at all, here?
   A. Depreciation of the cattle as well as the
farms would be in here.
   Q. It would be in the debt service or
someplace else?
   A. It would be in the -- well, it's -- the
debt service would be the interest.
   Q. The interest?
   A. But the -- but the -- but the $30 does
include the depreciation of the cattle as well as the
farms.
   Q. Cattle, farms, equipment, everything
else?
A. The tractors, the loaders, the -- yes.

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

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

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

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

Q. It's a grocery customer?

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

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

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

Q. The customer meaning the grocer?
A. Meaning the grocer, yes.

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

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

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

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

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

A. Yes, I know that.

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

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

Q. Okay. That's fine. And at the end of
that first bullet, you say: And the business succeeds today.

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

A. Yes.

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

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

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

A. There are three.

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

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

Q. And you?

A. No. I would be the fourth. There are
three national brands.

Q. Okay. National brands having their own brand label?
A. Yeah, they --
Q. Got it. The first bullet on the top of page 6 again, when you're referring to, in the last clause there, to successful, you're referring to the success of the product line, not the success of the company business?
A. Yes, sir.
Q. In the next paragraph you say: It's worth noting that most of our customers carry other organic milk in addition to that which we supply.
Are you there referring to milk that is offered by the retailer under a different label than the one you supply?
A. Yes.
Q. Okay. You are not intending to suggest that those customers carry milk in a brand that you share in common with another distributing plant?
A. Right.

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

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

BY MR. ENGLISH:

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

A. Good morning.

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

A. That would be right.

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

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

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

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

A. Yes.

Q. Okay. And were some of the owners of Horizon, as a privately-held company, some of the owners of Aurora today?
A. Yes. I would be one.

Q. And would another be Mark Retzloff?

A. Yes.

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

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

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

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

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

A. No, I don't know that.

Q. But whether or not that happened, you do know that the organic industry in general -- I'm happy
for that, more generalization -- the organic industry in
general, including the Organic Trade Association, sought exemption from at least the pooling provisions of
Federal Milk Orders from Congress, correct?

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

  Q.  Weren't exactly successful?

  A.  That's correct.

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

  A.  Yes.

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

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

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

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

  Q.  And it was as a result of the Milk Regulatory Equity Act that your regulatory treatment in Arizona changed, correct?
A. Yes. We are a producer-handler that is treated as a partially regulated distributing plant in Arizona.

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

A. Yes.

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

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

JUDGE CLIFTON: And so the answer is yes?

THE WITNESS: Yes.

JUDGE CLIFTON: Thank you.

MR. ENGLISH: Thank you, your Honor.

BY MR. ENGLISH:

Q. And in addition, you are obligated on
that volume of milk to pay the assessment by the Market Administrator pursuant to that section, correct?
   A. Yes.
   Q. And making that payment for the difference between the Class I price and the blend price adjusted to Weld County, Colorado, has not prevented you from continuing selling in Arizona, has it?
   A. Our Arizona sales are a very small portion of our total sales. Frankly, we have the sales in Arizona because they're important to the customers that we service there, and it is -- we have been able to continue to sell in Arizona.

   But what is at issue here is not of the same order of magnitude. And they're just not the same.
   Q. But on that volume of milk that you're selling in Arizona, you are able to pay the pool the difference between the Class I and the blend, adjusted to Weld County, Colorado, and still sell the product in Arizona, correct? Yes or no?
   A. Yes. As I stated, we sell product in Arizona.

   MR. ENGLISH: I have no further questions of this witness.
   JUDGE CLIFTON: Thank you. Let's go off record just a moment.
JUDGE CLIFTON: We're back on record at 11:11. Who will next cross-examine Ms. Keefe?
Mr. Beshore.

MR. BESHORE: Thank you, your Honor.

CROSS-EXAMINATION

BY MR. BESHORE:

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

Q. Have you been working in the organic industry continuously since 1996?
A. No. I -- between 2001 and 2003, I was at University of Colorado, where I got my MBA.

Q. Okay. So you were with Horizon from '96 to 2001 then?
A. That's correct.

Q. Okay. And then 2003 you began with Aurora?
A. That's correct.

Q. Okay. What was the status of Aurora in 2003 when you were first employed?
A. When I -- when I joined Aurora in 2003, the company was beginning to -- we were beginning the
organic transition of our dairy farm in Platteville, acquiring the funding to build a processing plant. And so at that time we would have been a conventional dairy producer until we completed the organic transition.

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

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

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

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

Q. The new company?

A. Yeah.

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

A. Yes.

Q. And was there more involved than that?

A. There was -- no. I mean, we were
Q. How big was the dairy operation in 2003?
A. That's actually a difficult question to answer because when -- the -- before we began the organic transition, the conventional herd was very heavily culled for a variety of different reasons. And then we -- but it was a fair-sized dairy farm. If memory serves, it would have been milking about 3,000 cows or so.
Q. Okay. Now, presently -- so is that like on one farm in Colorado --
A. That was.
Q. -- or more than one farm in Colorado?
A. It's -- it was one farm in Colorado that had multiple herds and so not all herds were taken through the transition.
Q. Okay. Now, presently you have five farms in Colorado and Texas, according to your testimony, correct?
A. That's right.
Q. Now, are all those farms owned by the corporation?
A. All of the farms are operated by the corporation. We own some of the farms and we lease some
of the farms, but they're all operated by us. We own all of the cattle so it's -- you know. But we're not -- we don't -- in some cases we have capital leases for the farms -- for the farm instead of owning it and having a mortgage with the bank.

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

Q. Were you involved in that decision-making process?
A. I was involved, but it was not my decision.

Q. Okay. Was anyone involved who knew anything about Federal Milk Marketing Orders?
A. Out of everyone involved, I knew the most at that time about Federal Milk Marketing Orders.

Q. And tell us again what your involvement was in that decision-making?
A. I was part of a team of people that were trying to decide what -- what a good opportunity would be within the organic milk category. And I identified that the private label segment was underserved and set about trying to structure a business that we thought could most ably serve that market.
Q. Did you look at options other than building your own processing plant?

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

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

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

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

We heard a lot about dependability, reliability, control, and so we wanted to make sure that
what we were offering had those features.

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

A. I was.

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

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

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

A. No, I wasn't.

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

A. I became aware of them later on. I first realized how contentious the producer-handler's place within the dairy industry is when -- in 2005 and 2006, in the run up to the Milk Regulatory Equity Act being passed.

Q. Okay. Now, what led -- what led Aurora
to expand from -- up to the 12,000 cows that you
identified today?

    Now, you started out with a herd that was
3,000 and then was culled heavily, I think you
indicated, from that, correct? Culled down to what
level?

    A. I don't remember.

    Q. Okay. Well, you started with less than
3,000 cows in 2003. Did your business model at that
time project expanding to the 12,000 you have today?

    A. Our business model at that time did
project expansion, as the plant that we built was as
small as we could do it for what we wanted to make, and
the amount of milk that could be processed in the plant
was more than the amount of milk that could be supplied
by the initial farm. And so yes, we contemplated
expansion from the beginning.

    We have subsequently done a modest
expansion of the plant's capacity, so at that time the
plant was sized so that we could -- so that we would be
looking at more like 8 to 10 thousand cows in milk.
Some of it has to do with the mix of the products
running through the plant and all of the rest of that,
so it gets complicated quickly.

    Q. Is the plant presently running at
capacity?
    A. No.
    Q. Over the last year has it run at capacity at any time?
    A. Yes.
    Q. What's your monthly milk production from 12,000 cows?
    A. As I indicated to Mr. Vetne, I'm not willing to discuss that.
    Q. Okay. Is Dr. Juan Velez an employee of Aurora?
    A. Yes, Dr. Velez is responsible for our milk production.
    Q. Does he know the milk production per cow?
    A. I also know the milk production per cow. I'm not willing to discuss it.
    Q. I understand that. But Dr. Velez, as the marketing person at the farm, does he know the milk production per cow?

JUDGE CLIFTON: Mr. Ricciardi.

MR. RICCIARDI: Mr. Beshore knows better than that. The objection is, how in the world can she know what he knows? It's speculation and calls for speculation from this witness, and obviously we don't want that kind of information
in the record.

JUDGE CLIFTON: Well, maybe she read it in the newspaper. Mr. Ricciardi, I'm just being facetious. You know that.

MR. RICCIARDI: I understand that, Judge.

Apparently the newspaper is the standard. I didn't know that.

JUDGE CLIFTON: Mr. Beshore, you may establish whether this witness knows what Dr. Juan Velez knows about the monthly milk production of the cows.

BY MR. BESHORE:

Q. What are Dr. Velez's responsibilities with Aurora?

A. Dr. Velez is responsible for our farm operations.

Q. And by that, all five farms?

A. Yes.

Q. Okay. So he is the chief operating officer of the milk production program of Aurora Dairy?

A. He'd like that title. Yes.

Q. Okay. In his capacity, do you think he knows how much production he gets per cow?

MR. RICCIARDI: Your Honor, do I have to step up or can I have my last objection read
JUDGE CLIFTON: I'd like you to say it again.

MR. RICCIARDI: Your Honor, Mr. Beshore knows better than that. It is calling for speculation. How in the world does she know what he knows based upon that question?

MR. BESHORE: Well, I would note that she's a corporate representative testifying in that capacity.

JUDGE CLIFTON: Just ask her if she knows whether Dr. Velez knows.

MR. RICCIARDI: That would be a good question.

MR. BESHORE: I will adopt the Judge's question, Ms. Keefe.

THE WITNESS: Could you --

JUDGE CLIFTON: You need to ask the whole question.

Q. Do you know if Dr. Velez, the operations manager of the farms, knows the milk production per cow? I'm asking for an annual figure that he gets at those farms.

A. Yes. Dr. Velez, as well as myself and the other members of the management team, are well aware
of our milk production per cow, per day, et cetera. But I'm not willing to discuss confidential business information.

Q. As to whether that information is confidential, are you aware -- were you here when Ms. Arnold testified, when the organic handlers testified?

A. No, I was not.

Q. Let me represent to you that there was a panel of organic dairy farmers that testified, and one of them testified to a visit to one of Aurora's farms at which Dr. Velez spoke to these outsiders about their milk production per cow.

Now, he, according to his testimony, told everybody what the milk production per cow was. And I suggest to you that it's not really -- that would suggest it's not really a confidential matter.

With that understanding, are you willing to provide for this record the information that you've said you have about milk production per cow?

JUDGE CLIFTON: Mr. Ricciardi.

MR. RICCIARDI: I was hoping there was a question in our future. The fact is, Judge, the lead-up to that is asking this witness to speculate about what testimony we got in this
record from somebody who might have had a conversation, who might have had another conversation with a third person. We're in totem pole hearsay. I think we're at about the level of four. And I don't think that this is a fair question and this record doesn't need it.

And it's, by the way, not very relevant at this point either. So those would be my objections.

JUDGE CLIFTON: All right. Let me chime in a bit. That witness did state what the group that she was part of had been told by Dr. Velez. As it is now -- since Dr. Velez has not been a witness here, there's been no way to test that evidence to see if that is, in fact, what Dr. Velez would say he said, or whether that's what Dr. Velez now believes. So you have the opportunity to present evidence on that issue if you want, but it's entirely up to you.

Mr. Beshore, go ahead and ask a question.

MR. BESHORE: I did.

JUDGE CLIFTON: Do you want it read back or do you want to ask it again?

MR. BESHORE: I'll ask it again.
Q. In view of the fact that there's been testimony here about what Dr. Velez told these outsiders what was Aurora's production per cow, would you now testify for this record that nonconfidential information as to Aurora's production per cow, an annual figure?

A. No. I'm not willing to discuss our annual production per cow.

Q. Okay. You said that there are 12,000 cows, and those are the cows in milk, correct?

A. Yes. That's on the average.

Q. On average, right. And you also indicated, if I got your testimony correct, that there would be approximately 3,000 cows dry at any time?

A. On the average.

Q. On average?

A. (Nodding head.)

Q. Okay, just looking for average. Not asking for precision to the cow.

When we're -- so there are roughly, on average, 15,000 milking-age cows, milking head of cows in the Aurora herd?

A. Yes, that would be the total across all of the herds.

Q. Okay. So if one wished to estimate the total production annually from the herd, you would use
the total head, the total numbers of milking head, against an annual figure to come out with a total gross production from the herd, correct?

A. Could you state that again? I'm not totally following the math.

Q. Okay. Well, when -- production per cow in a dairy herd, when that figure is used, it includes all cows in the herd, knowing that at any given month during the year every cow is going to be dry for some period during the year, correct?

A. Yes, every cow is going to be dry for some period of time during the year. I think it's well-known within our industry whether you're -- you can look at pounds per cow per day when the cow's in milk. You can look at rolling herd averages versus the total. You know, I don't know what this is adding.

Q. But when you're looking at the total production in a herd, you use the number of cows, which includes the total herd, not just the number that happened to be milking at any given time?

A. That's -- yeah -- I mean, that's one way you can do the math. You can get to the same number in a different way, too.

Q. If we were working with production per day, you'd get it in a different way?
A. Yeah.
Q. Okay.
A. I'm not particularly familiar with rolling herd average. I think about it more in terms of pounds per cow per day in the tank for me.
Q. Do you care to share that number?
A. No, I don't.
Q. Okay. You say Aurora Organic Dairy is a leading supplier of private label and store brand organic milk. Do you have your own label at all?
A. We have what's known in the trade as a control brand. It's called High Meadow. Sometimes customers will want to -- will want to see if -- see if it's a good idea or not. And so they might -- they might pick up High Meadow and then convert it over to their brand later -- convert to their brand later on, so the --
Q. Other than the High Meadow brand, all your fluid milk products are packaged under private label or store brands?
A. Yes, that's correct.
Q. Okay. When you're dealing with large regional and national customers that you've -- as you've indicated you do, they may have, and probably would have, one store brand throughout all their -- all their
stores?

A. Some would, some wouldn't. I mean, they don't always use the same brand for organic versus conventional. Some of them have multiple in-house banners. There's a wide variety of things out there.

Q. I guess my question is, do you package in a store brand or a private label which -- under which other -- some of your competitors also package for customers?

A. There are some national accounts where we are not the sole supplier. However, that's always the customer's choice, frankly. We prefer to be the sole supplier, but that's, you know, not -- it's not up to me.

Q. I understand that. It's up to the customers?

A. It is up to the customers.

Q. And you prefer to be sole supplier, which I understand. I'm sure your competitors prefer to be sole suppliers as well. But it's not unusual for a national or large regional customers to have more than one supplier for certain private labels or store brands -- store brand lines, correct?

A. It's not unusual. I mean, they look at it lots of different ways. They may not want to be
dependent on one vendor. They may want to -- they may -- they may want to look at it in terms of different regions of the country.

So there's -- you know, there's lots of different things out there. But that's the customer's choice. You know, it's not -- not my choice.

Q. Correct. Now, I understand that. I'm just trying -- you have a lot of knowledge about how -- the marketplace out there.

A. Thank you.

Q. And that's what I'm trying to learn for the record here.

So some of those accounts may have -- you may share some of those accounts. Although you'd like to have them all, be the only supplier, you may share some of those store brands or private label accounts with Horizon Organic for some customers?

A. No. However, I want to note that I'm not aware of anyplace where we're supplying a private brand at the same time that they're buying it from somebody else through the same distribution center into the same store.

Q. Okay.

A. It's -- it's much more -- I'm -- I'm concerned. I feel like you are oversimplifying it a
little bit. And it's -- their vendor selection decisions are at times complex and mysterious.

Q. Okay. So they may be -- you may share on a regional basis, is that --

A. Yes, I might supply one region of a national retailer and another vendor might supply a different region.

Q. Okay. And those vendors could be Aurora and Horizon, Aurora and Organic Valley or Aurora and HP Hood or a combination of those?

A. And others as well. There are some smaller folks supplying as well.

Q. Now, on page 2 of your statement, Exhibit 88, you've indicated that you balance your milk in a number of different ways. And I'm just wondering if you could tell me -- tell us a little more about what you mean by balancing item number 1, careful management of our finished goods inventory.

A. We are primarily a processor of extended shelf life ultra pasteurized organic milk. Because the shelf life of UP milk is longer than that of HTST, high temperature, short time milk, we can -- we can float the peaks and valleys over the course of a week or two.

And so we -- we very -- we very carefully manage that inventory. And, frankly, we maintain a
higher inventory, I believe, than other -- than other UP processors because since we're self-supplying, I have to be able to hit the peak.

    And so -- so we're keeping -- we're keeping more days in inventory. We have more working capital tied up in that.

Q. Okay. By hit the peak, you mean the peak of customer/consumer demand?

A. I mean to hit the peak of customer orders. The -- the cows are a lot more steady than the customers.

Q. So you believe that you carry more inventory than some other processors, more finished goods?

A. I think so.

Q. Do -- is price a factor in managing your inventory at all?

A. I don't understand. Could you expand the question?

Q. Do you use the price at which you sell your products as a factor in managing your inventory?

A. Do you mean do we adjust the price in order to move more inventory?

Q. That might be one -- that might be one way in which you could use price.
A. No. Our agreements with our customers don't allow us to move the price like that. You can't do that.

Q. Does your price move monthly?
A. No.

Q. It's fixed over a long period?
A. Yeah. It's -- our prices are agreed to in advance over the course of -- and they need to be adjusted over the course of long periods of time, not monthly.

And we have to provide advance notification -- advanced notification as well on, generally, anywhere from 30 to 90 days of a price change. So the time horizon for the two things, they don't match up. I can't change the price fast enough to affect the inventory.

Q. Very good. You've also indicated that you balance your milk by -- this is point number 2, production of butter and powder at co-packers. Now, do I understand that your plant processes only fluid milk products?
A. Yes. That's correct.

Q. Okay. And you don't make any what we call Class II products, cultured products at your plant?
A. No, we do not.
Q. Okay. When you're referring to co-packers with respect to production of butter and powder, those are manufacturing facilities owned by other companies?

A. Yes.

Q. Now, if you occasionally -- very occasionally are -- are you ever short of milk?

A. Yes.

Q. It's possible to buy certified organic milk from pool sources, is it not?

A. It is -- it is possible to buy limited amounts of certified organic milk from pool sources. And my understanding, for us to remain in compliance with the requirements of the Central Order, that any milk that I do purchase from outside my own sources actually has to be from a pooled source.

Q. Just so there's no question then -- because there was something in your statement that suggested, to me at least, that certified organic milk might not be available for pooled sources -- it is available and you do source occasional loads when you need them from pool sources as required by the Order, correct?

A. We occasionally purchase up to but not more than 150,000 pounds, but there's a big difference
between buying three bulk trailer loads of milk and the amount of milk produced by 12,000 cows, no matter how you do the math.

Q. You're producing a lot more than that?
A. Yes.

Q. Okay. Now, you say the cost of production is about $30 per hundredweight at your farms. Do you have any information that would suggest that the cost of production of certified organic milk on pool -- on farms that are pooled on the Federal Order, let's take Order 32, is any less than your cost of production?
A. I'm not aware of any -- of any studies or anything like that that have looked at other -- the cost of production for any other organic producers --

Q. Okay.
A. -- in the geographic regions of the Central Order, no.

Q. Okay. With farms that -- of the size of 15,000 milking head, milking --
A. Mature head.

Q. -- mature head, you've got some significant economies of scale in the production of your milk supply, do you not?
A. We enjoy economies of scale on our farm production, but I would agree with the -- with the dairy
literature that suggests that there's a point in time at which the economies of scale in farm production begin to drop off, that you -- that your herds get bigger, but you stop seeing a decrease in production costs.

Q. And where do you feel like -- on the basis of the literature and your own experience, where do you feel that point is?

A. I feel like the point changes around a thousand cows or so.

Q. When you were answering a few questions from Mr. Vetne about how you calculate your costs, I think he suggested -- I just want to make sure I didn't misunderstand him or you on this, that you suggested in response to his questions that as far as farm level costs, that you depreciated the farm?

A. The $30 a hundredweight includes the -- it includes the depreciation and the amortization as well as the interest expense, so it's all there, which isn't apparently the norm.

Q. Okay. But not actually considering that the land is depreciating in value and charging that as an expense of your production?

A. What we're looking at there is the depreciation for the -- related to the facilities on our farm.
Q. The buildings and equipment?
A. (Nodding head.)

JUDGE CLIFTON: Did you respond to his question, building and equipment?

THE WITNESS: Yes.

Q. Your statement says on page 6 -- and maybe we've covered this a bit -- but it says, most of our customers -- this is the first full paragraph at the top: Most of our customers carry other organic milk in addition to that which we supply.

Do you see that sentence?
A. I'm sorry. Which page are you on?

Q. Page 6, the first full paragraph at the top. I'm looking at that.

JUDGE CLIFTON: And what sentence do you want her to focus on?

MR. BESHORE: The sentence -- I'll just read it.

BY MR. BESHORE:

Q. In addition, it is also worth noting that most of our customers carry other organic milk in addition to that which we supply. It's the second sentence preceding --

A. Is it after the bullet point? I think I'm just a little confused as to where you are.
Q. Yeah, it's the paragraph below the bullet point.
A. Okay.

Q. Okay? It's the second to last sentence. It's the fourth sentence in the paragraph. It says: In addition, it is also worth nothing that most of our customers carry other organic milk in addition to that which we supply, okay?
A. Uh-huh.

Q. Now, setting aside in California -- by the way, do you have distribution out in California?
A. Yes, we do.

Q. Setting aside California, because it's not part of the Federal Order System, when you are supplying customers in the Federal Order System, those other suppliers are, you know, almost universally from pooled sources, correct?
A. Sometimes, but not always.

Q. What are the nonpooled -- other nonpooled sources of organic milk? Are there any major -- major ones?
A. There's a major -- I believe that there's a major organic milk processing plant in Nevada.

Q. Okay. And that's not federally regulated, so they would have some supplies in some
Federal Order areas, is that your testimony, to
customers in some Federal Order areas?

A. I think so. I mean, you're asking a very
broad question.

Q. Right. Well, your statement is very
broad: Most of our customers carry other organic milk
in addition to that which we supply.

I'm trying to get a little more detail on
that. By the way, you supply customers in Federal Order
1, correct?

A. Yes.

Q. Okay. Federal Order 5?

A. It would -- could you use the -- the
names and the numbers?

Q. Sure, I'd be happy to. Okay. Maybe we
can do it really easily. Do you supply milk in every
Federal Order?

A. Not in every month.

Q. Okay. But in some months, you have
supplied milk in every Federal Order?

A. At some point we've had sales in every
single Federal Order. We also have sales in unregulated
areas, and we also have sales in California.

Q. Okay. How many Federal Orders do you
have regular sales in, basically every month, on an
ongoing basis? I'll start with the Northeast is Federal Order 1. Would that be sales every month?

A. Uh-huh.

Q. Yes?

A. Yes.

Q. Okay. The Appalachian Order, Federal Order 5?

A. No.

Q. Okay. The Southeast Order, Federal Order 7?

A. In between. So not always, but most of the time.

Q. That goes as far as Arkansas -- I mean, goes as far west as Arkansas and the southern portion of Missouri?

A. Are you on 6 or 7?

Q. 7.

A. Oh, that's -- 7 is all of the time. 6 is some of the time.

Q. 6 being Florida, some of the time. 7 all of the time, however?

A. Uh-huh.

Q. That's yes?

A. Yes.

Q. Thank you. 126, the Southwestern Order,
which is Texas?

A. We have sales in Texas all the time.

Q. Arizona, the small -- the limited -- somewhat limited, I guess, sales that you referred to with Mr. English, all the time?

A. Yes.

Q. Okay. And Order 32, all of the time?

A. Yes.

Q. Order 30, the Upper Midwest Order?

A. Some of the time.

Q. Okay. The Order 124, the Pacific Northwest Order?

A. All the time.

Q. Order 33, the Mideast Order, that would include Ohio, Indiana, Michigan and a little bit of Kentucky and West Virginia and Western Pennsylvania?

A. All of the time.

Q. Okay. Thank you. Have you calculated what Aurora's pool obligation might be if you were a fully regulated handler in the Federal system, Federal Order System?

A. I've tried to estimate it, but we -- you know, I'm not quite sure -- I don't know exactly what it would be. But it would be millions of dollars a year for us.
Q. It would be millions of dollars a year?
A. Yes.

Q. What are the total annual sales of Aurora?
A. We don't release that information publicly.

Q. Now, you make the statement on page 8, the last page of your testimony that: Some of the proposals, frankly, punish vertical integration in any form other than a cooperative.

And I'm interested in what -- in what you might mean there. You have been here for some of the portions of the testimony, correct?
A. Yes, I've been here for some portions of the testimony over the course of the past couple of weeks.

Q. Okay. Were you here when Mr. Lee from Prairie Farms testified?
A. No.

Q. Okay. Let me suggest he's -- Prairie Farms is a cooperative. Are you aware of that?
A. Yes.

Q. Okay. And they're also a processor?
A. Uh-huh.

Q. Okay. And their plants are fully pooled
and subject to all the pricing regulations of the order. Are you aware of that?

A. No. But I'll take your word for it.

Q. Okay. Well --

MR. VETNE: Excuse me, your Honor, that 
misstates the record.

JUDGE CLIFTON: Mr. Vetne, I'll hear you.

MR. BESHORE: Sorry, Central Dairy.

MR. VETNE: Got it. Go ahead.

MR. BESHORE: Okay.

JUDGE CLIFTON: See, I love this bar. I 
absolutely love the lawyers who do these 
hearings. You are so knowledgeable. My hat is 
off to you. Mr. Beshore, begin again.

BY MR. BESHORE:

Q. Okay. Just accept that Prairie Farms 
owns and/or operates a number, and I don't -- I won't 
give the number because I don't know -- can't 
recapitulate the precise number, but, you know, more 
than a half dozen fully regulated pool plants, that the 
cooperative, the farmers own -- own those plants and 
they are fully priced and pooled under the order. That 
was his testimony --

A. Uh-huh.

Q. -- okay? Now, your statement seems to
suggest that this proposal -- the proposals, and you're
talking there about -- when you make the statement on
page 8, you are talking about Proposals 1, 2, and 26, I
assume?

A. Yes.

Q. Okay. That they would punish vertical
integration in any form other than a cooperative. Now,
if the cooperative processor is already fully pooled and
regulated, and the effect of this proposal would just
make Aurora fully pooled and regulated, how is that
punishing your vertical integration?

A. I believe that if Proposals 1, 2, and 26
were adopted, the most advantageous vertical integration
position to be in would be that of a cooperative, not
that of a producer-handler.

Q. Okay. How -- what do you understand
about cooperative vertical integration? What aspects of
that are you addressing there?

A. I'm -- I don't know a lot about
cooperative vertical integration. But as -- as a former
cooperative dairy producer, I observed tremendous --
that the cooperatives had tremendous market power, both
with their procurement with their producers as well as
the sales with the customers. And the ability of the
ways in which cooperatives are able to negotiate
over-order premiums, producer prices and the like, it's a little different than what the way our business works.

Q. Well, the difference right now is those plants have to pay into the pool and you do not have to, correct?

A. I think there's a lot of other differences between a cooperative and my business.

Q. But that's the difference that you want to maintain?

A. It's actually one of the differences I want to maintain.

Q. That's the difference that's involved in this hearing that you want to maintain, correct?

A. That's correct.

Q. Yes.

MR. BESHORE: Thank you very much.

JUDGE CLIFTON: Thank you, Mr. Beshore.

Is there other cross-examination for Ms. Keefe?

Let me begin with Mr. Yale.

CROSS-EXAMINATION

BY MR. YALE:

Q. Benjamin F. Yale for Continental Dairy Products and Select Milk. Good after -- good morning, still.

A. Oh, excellent. Good morning.
Q. I'm not guaranteeing you it'll stay that way before you get off, but good morning.

I kind of want to follow up. There were some questions on the retail that Mr. Beshore asked. And I just want to make sure that that's clear.

You've been through some of this hearing this week, right? You've heard some of the testimony?

A. Yes.

Q. And maybe you've read some testimony?

A. Yes.

Q. All right. And you understand that one of the contentions is that producer-handlers, there's a -- a scheme or a model or whatever where a producer delivers to a store under the store name all the milk that the producer-handler can, and if that's not enough for the store, the store goes out and buys it from a pool plant or some other source and uses the same label so that the consumer thinks they're getting the same milk, but, in fact, it comes from two different sources. You are aware of that? You've heard of that?

A. Yes, I've heard of that.

Q. All right. And that -- the contention is that, in fact, the pool plant is balancing the supply of that producer-handler under that scheme? I mean, that's -- you've heard that?
A. I've heard that contention. But in my experience with our private label customers, that's not the way that it works at all.

Q. Okay. And that's what you were saying. Although there may be multiple sources of the same brand to the same customer, but it's not at the same location at the same time?

A. That's right.

Q. All right. You would not walk into any of your customers' stores and see the same brand with different plant numbers on it?

A. That would be -- that would be unusual for the same size format. But you might see -- you might see the same brand with one vendor supplying half gallons, another vendor supplying gallons, another vendor supplying the -- the heavy creams and half and halfs and the like.

I mean, that's the customer's choice as far as which -- which supplier is the best fit for -- for the product.

Q. And do you think that in some ways is somewhat unique, though, because it's organic or --

A. I don't have any reason to believe that it behaves that much differently than conventional. But I recognize this has been the subject of great debate.
Q. Now, at the top of page 7 you asked a number of, I guess, rhetorical questions. And I kind of got -- getting kind of the music or something that comes through with this. The bigger picture is that -- are you suggesting that in reality organic milk and conventional milk really are two completely different products?

A. Yes.

Q. So that the mechanisms that are set up to balance -- let me -- I want to -- let me back off that. I want to ask you another question that I was intrigued about. The concept -- I hadn't really thought of it but it kind of made sense during your testimony. You talk about you have UHT, which is ultra high temperature packaging?

A. Yes.

Q. And extended shelf life?

A. Yes, our pasteurization process is -- for the most part, most of the milk that we sell is UHT pasteurized, ultra high temperature. And then our fillers are ESL fillers, extended shelf life fillers.

Q. All right. You don't do any standard pasteurization?

A. We do do some of that, a small amount. That is, again, the customer's choice.
Q. Okay. So let's talk about that product for a moment. The conventional pasteurization, are there regulations in terms of how soon that product has to be removed from your plant and in the store?

A. Well, there aren't regulations about how soon it has to be removed from the plant and put in the store. You can let it spoil in your racks and go out of business quickly. Because a high temperature, short time pasteurization isn't going to lead to the same shelf life, you have to move it through your inventory and to your customers much more rapidly. And it's much more difficult to -- to use inventory as a balancing tool for -- for an HTST milk.

Q. And the reason is because it has such a short life, you've got to get it out into the store, right?

A. Yes.

Q. So I'm not looking for specific or proprietary information, but typically the high temperature, short time pasteurization, the shelf life is -- runs two weeks, ten days, what -- I mean --

A. In my experience, you know, day of fill, two to three weeks would be a norm right now.

Q. Okay. And that's through the industry, that's not just organic or not just --
A. Right.

Q. And then the extended shelf life is a higher step. It's not necessarily UHT, right?

A. Right. There is a medium step where we don't -- we don't do the medium step.

Q. Oh, okay. So your extended shelf life is UHT?

A. Our extended shelf life product is UHT. We do an ultra high temperature pasteurization and we use ESL, extended shelf life, fillers. They are extraordinarily expensive and extraordinarily clean.

Q. All right. Sometimes you talk about aseptic packaging?

A. Right. We don't do aseptic packaging. Ours -- our milk, when you see it in the store, is in a gable-top carton. An aseptic process would take a UHT pasteurized milk and then put it into an aseptic brick. It's then shelf stable and doesn't even require refrigeration. Our product does require refrigeration.

Q. The term brick refers to the box that it's in. It's not a brick that you'd build a house with, right?

A. No. They look like bricks.

Q. So typically the UHT shelf life would run several months?
A. A UHT shelf life is typically going to be at least 60, days but it's not going to be a lot longer than that.

Q. Okay. Now, what does -- in the -- in the stores there are -- different days of the week have different sales volumes, is that correct?

A. Yes.

Q. All right. And by -- I think what you were saying, by your inventory management, is that you can have a steady supply of milk coming in, relatively steady, and process it and UHT it and store it, and then use that as kind of a balancing to meet those day-to-day fluctuations and the store demands, is that what you were saying?

A. That's correct.

Q. Which is not readily available to conventional pasteurized milk, is that right?

A. It would be much more difficult to do it with a HTST product because of the shelf life involved.

Q. And as a result, you don't have the need for a balancing of the market for those day-to-day fluctuations?

A. No, not for -- not for the day-to-day fluctuation. But we do -- I -- I chose the word burden of balancing, those words on purpose. We do expend a
great deal of money and a great deal of effort on balancing over -- over the course of the months and years. We happen to have a very unique tool for the near term, for the days and weeks end of the equation, as opposed to the months and years.

Q. So coming back to that comment in 7, is that -- that the mechanisms, the balancing, the type of product that you sell, the way it's marketed, and, in fact, it -- well, let me back up.

Organic has -- I think you've testified, has a specific standard of identity by USDA's standards, right?

A. That's correct. In order for your milk to be labeled with the USDA organic seal, it must be produced and certified in accordance with the National Organic Program regulations.

Q. So the way I understand the thing, what you're saying is these -- all these systems that we've designed to protect producers and processors in conventional milk really do not apply to the niche with the organic and the way that you're set up, is that --

A. It frequently feels like a square peg in a round hole.

Q. Now, do you know what percentage of organic milk is produced by producer-handlers nationwide
as compared to that that's pooled?

A. I have no idea.

Q. Is the ratio -- do you know whether the ratio is higher than conventional milk in terms of PD to the regulated? Or would you have any -- do you have any way of even guessing?

A. I don't really know. I do notice that there are -- there are a lot of -- there are a lot of exempt plants that are processing organic milk. And I think that many of them are actually producer-handlers that are exempt because of where their sales volume is at.

And then also within organic there's a great deal of interest in artisan farmstead cheese. Again, that's a little different, you know, own-farm value added sort of thing.

Q. Your request doesn't ask the Department to exempt from the pricing regulations organic milk, right, because it's organic?

A. No. That's not the issue at hand here.

Q. Okay. In the Class I price in series that USDA reports from the various markets, is that used in the establishing of the pricing of your milk products?

A. No.
Q. And one final question. There was a -- again, almost a rhetorical comment or question made by a witness earlier -- I guess it may have been last week, I can't remember; it's all starting to blend -- that he said he'd like to see how you could pasture a thousand cows on ground. Do you remember that? Do you recall anything that was said to that?

A. I don't remember that.

Q. But, in fact, your farms, you do have -- they have some very, very, large acreage, is that right?

A. Yes. We do. Our farms are surrounded by over 4,000 acres of pasture.

Q. So on a beautiful blue day -- sky day with a few clouds in West Texas, one can go to that farm and see this fantastic sight of thousands of black and white Holsteins walking through this deep green field, is that true?

A. Yes, and you'll also see some Jerseys and some crossbreds.

Q. Okay. I didn't want to leave out the other herds. I wasn't trying to be discriminatory. But it does happen and it is happening, and it's a very beautiful sight?

A. It's a truly wonderous thing.

MR. YALE: Okay. I have no other
JUDGE CLIFTON: Thank you, Mr. Yale.

MR. CARROLL: Your Honor, I meant to signal, but I may have not done it effectively.

JUDGE CLIFTON: I'm sorry, I didn't see. I'm sorry. Would you please go before Mr. Tosi, Mr. Carroll, if you're ready now? Mr. Carroll, you may go now.

MR. CARROLL: All right.

CROSS-EXAMINATION

BY MR. CARROLL:

Q. How many employees at your plant? Do you have an approximate size?

A. The plant -- out of the total employees, the plant is about 75.

Q. And how many employees overall are there in the farm?

A. Overall, there are 345.

Q. And directing your attention to the impact of the total loss of exemption, what impact, if any, would that have on your business?

A. As I indicated to Mr. Beshore, we believe that becoming a fully regulated pool plant would increase our costs by millions of dollars a year.

Q. Other than increasing your costs, would
it cause you to have to make any changes in service or quality of product?

A. You know, I think that candidly it's difficult to know what exactly would make sense in that world, and you know -- but it -- I believe that the structure that would make the most -- that would make the most sense for us then would be very different than what we look like right now.

Q. Do you have any idea what that structure would look like?

A. Not yet.

Q. I take it you're in hopes you don't have to reach that point?

A. Yes, I am in hopes that we -- we don't go there.

Q. I want to direct your attention now to the last page of your statement at page 8. You make the statement: Aurora believes that any national policy that is adopted should preserve options, not foreclose them. Some of the proposals, frankly, punish vertical integration in any form other than a cooperative. This is potentially -- quintessentially anticompetitive and bad for consumers because it freezes the United States marketplace. It picks one business model as the winner. It stifles entrepreneurial enterprise, and it
eliminates independent vertically-integrated operations that meet changing consumer depends.

Directing your attention to that statement, why do you think that's bad for consumers?

A. I think that as a group, the producer-handlers, while we're all a fairly independent and disparate bunch, I think we are all serving very different consumer niches. We are very consumer and customer focused. And, you know, for us, the example is private label organic milk.

Candidly, that's -- before we started doing it, it wasn't really being offered even. And there's proven to be demand for it. Now, other people in the marketplace are offering it, too. And you know, consumers have benefited.

Q. And one other question that's a little bit off the point. You went to school at Middlebury?

A. I did.

Q. Are you familiar with my clients? I have Monument Dairy, and I take it you must have had their milk while you were in school?

A. Middlebury College has the best dairy products in the dining hall, bar none. And I realize that that's an unusual thing to say in this room where there are so many who are proud of the Penn State or the
Cornells or the Wisconsins, but the products that
Monument Farms and other farms in Vermont supply to the
dining halls at Middlebury are remembered and loved by
all alums.

Q. And do you understand their testimony is
that they would be forced out of business if this
proposal was established? Would you support that
result?

A. No.

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

JUDGE CLIFTON: Thank you, Mr. Carroll.

Mr. Tosi.

MR. TOSI: We have no questions, your
Honor. But we'd like to thank Ms. Keefe for
coming all the way from Colorado to testify here
and participate with us. Thank you.

THE WITNESS: You're welcome.

JUDGE CLIFTON: Redirect, Mr. Ricciardi?

REDIRECT EXAMINATION

BY MR. RICCIARDI:

Q. Al Ricciardi for AIDA. And I might note
that given the time from when we started and the time
we've come back together, I feel like I'm coming back to
talk to a long-lost friend, Ms. Keefe. So let me see if
I can wrap up a couple of points.
You were having a discussion, I believe it was with Mr. Beshore, with regard to distinguishing between the cooperative model and the producer-handler model. And I don't think you got to explain the risks and the burdens that are associated with operating under the producer-handler model as much as you wanted to, so I'm giving you that opportunity now.

A. Some people have suggested that an individual handler pool is a little bit like a producer-handler, which is a little bit like the way a co-op might behave. And it's -- it is very difficult to operate independently, to invest heavily in both the farming side of the business as well as the processing side of the business and through balancing make it all work together to effectively serve the marketplace.

And I think that a producer-handler is one way of being vertically integrated on a scale that's a little bit smaller than some of the other models within our industry.

Q. And with regard to that model that you just started to describe, there are significant risks, whether they be financial or otherwise, that the other models don't have to bear?

A. That's correct. As a producer-handler, you bear the full risk and responsibility for both the
farming -- for both your farming operations as well as
your processing operations, your marketing, your
distribution. You have to carry it from cow to carton
and then some.

Q. Okay. You were also -- I'm going to go
to another point.

You were also asked some questions, I
believe by Mr. English, about whether or not Aurora is
actually required to make payments into the pool as a
partially regulated plant or not in Arizona for sales
there. There were comparisons raised between that
partial regulation and what would occur if, in fact, the
producer-handler model was eliminated coming out of this
hearing. Can you explain the differences in magnitude
to Aurora's business?

A. Given our volume of sales in Arizona, our
obligations as a partially regulated distributing plant,
there are on the order of a few thousand dollars a
month. And, you know, they don't -- they total -- it's
not even -- it's not even a six-figure number for a
year. And whereas what we're talking about here is the
national elimination of producer-handler status. And so
that is something that any cost for a business like ours
with thin margins, that is, millions of dollars a year,
is something that you need to think very hard about.
Q. And on that point, if Aurora is required to be fully regulated and pay into the pool to everyone in that particular order, did the people who are going to get that money actually invest or take the risk with Aurora when Aurora was making the decision to become a producer-handler?

A. No, they didn't invest or take the risk with us when we were making the decision to become a producer-handler. They didn't take the risk to transition to organic even. The -- the simple fact of the matter is, is that there's an extraordinarily limited supply of organic milk where I am.

In Colorado, in addition to -- to my three organic dairy farms, there are two others. In Texas, there are a handful of organic dairy farms. We're talking about a very specialty milk supply that -- that we have a system here that's putting -- putting the square peg in the round hole. It doesn't work very well from my perspective.

Q. I'm going to ask you another -- another point. I think there were some questions that were raised by Mr. Yale with regard to the processing that Aurora uses for the organic product --

A. Uh-huh.

Q. -- the UHT. Is that the current standard
within the industry?

A. Within the organic industry, UHT is very much the norm and the customers prefer it. We designed our plant with the capabilities to do either, and have frankly been surprised at how low the demand has been for the high temperature short time, HTST, organic milk.

Q. You indicated that it was customer or consumer demand. Is that the standard that the customers want? Is that why Aurora uses it?

A. Yes, we use it because it's the standard that the customers want. Within private label, it's very common for the customers to -- to require that you meet the national brand equivalent. In our case the national brand equivalents are ultra pasteurized.

Q. And then I have a general question. During the course of many of the questions that were raised to you, you raised concerns about inquiry into Aurora's confidential or proprietary information. Is that the policy of Aurora, not to provide or disclose that information?

A. Yes. It's our policy not to provide or disclose that information. We're a privately-held company. We do fully comply with the reporting requirements for the orders. And, you know, not the farm production stuff that Mr. Beshore was so interested
in, but, you know, a lot of the information about who we're selling to and the whats, wheres, and whys and all of that is reported to the Central Order each and every month.

Q. That type of information is reported to the MA's office at the USDA and is then held as confidential under their particular policies, right?
A. Yes, it is.
Q. Okay. Last area. One of the proponents of Proposals 1 and 2, which declined actually to even agree to Proposal Number 26, is IDFA?
A. That's correct.
Q. Now, I'm surprised by this, but isn't Aurora an IDFA member?
A. Yes, we are.
Q. And did they consult you before they decided that they were going to try to take a regulatory position that might detrimentally affect your business as a member?
A. No, they did not.
Q. And what's your position on that?
A. I was very disappointed.
Q. Are you currently disappointed?
A. I remain disappointed.

MR. RICCIARDI: Thanks.
JUDGE CLIFTON: Ms. Keefe, your testimony here is extremely important. You're uniquely positioned, from what I've heard in almost two weeks of testimony. And I thank you very much for appearing.

THE WITNESS: You're welcome.

JUDGE CLIFTON: All right. Ms. Keefe may step down. And, Mr. Ricciardi, what would you like to do next?

MR. RICCIARDI: Get a couple hours' sleep, Judge. Your Honor, we can proceed, if you would like. The next witnesses are going to be the dairy economists. We can either go forward with that at this point, or we might want to end up taking a lunch break at this moment before we start them, so they won't be interrupted.

JUDGE CLIFTON: All right. I'm going to ask by a show of hands how many would like to start our lunch break now. If your answer is yes, raise your hand that you would like lunch now. And if your answer is no, you'd like to get into the testimony of it first, raise your hand.

You know, if Messrs. Beshore and English
are ready to get into the testimony -- they're the ones that just got the statements today -- then I think we should have a little testimony.

MR. BESHORE: We could have the direct perhaps.

JUDGE CLIFTON: Okay. Good. We won't go too long. I don't want anybody to faint during this testimony. Mr. Ricciardi.

MR. RICCIARDI: At a minimum, Judge, if we're going to do this -- at a minimum, Judge, if we are going to start, can we take a six-minute break?

JUDGE CLIFTON: No, we need more.


JUDGE CLIFTON: Yeah. Please be back and ready to go at 12:30. That gives you eleven minutes.

(A recess was taken from 12:24 to 12:37.)

JUDGE CLIFTON: We're back on record at 12:37. While we were off record Mr. English made a suggestion. I'm going to ask that he repeat it.

MR. ENGLISH: Thank you, your Honor. And during the break I tried to get agreement. I don't think I did, but my suggestion was that
the vast majority want to go to lunch and we're for the -- I, for my part, do not wish to stand in the way of that. I raised my hand because you asked me what my opinion was.

The real concern here -- two different concerns. One is that Dr. Yonkers, who has been here since the first day, needs to leave by noon tomorrow. And I think that it's one thing for a witness to be here a couple days. It's another thing to be here a couple of weeks. To ask him to keep being kept off, I think, is a problem and ultimately inappropriate. And he really does have to leave by noon tomorrow.

Second, while the rules of practice are clear that the beginning of the morning you get statements of proponents and that was complied with, we clearly have had statements this morning for two economic experts. They are very significant, lengthy, you know. Whether they are meat or not will depend on what happens next. But there are certainly some substantial materials there to be discussed.

Dr. Cryan and Dr. Yonkers put their statements out last Monday and everybody had an opportunity to pursue them at great length,
before either witness went on the stand,
certainly before cross-examination.

And therefore, we really think in
fairness to Dr. Yonkers, we need to get him,
really, done today. I had some discussion with
counsel. I was hoping to get agreement. We
didn't quite get agreement.

I believe that the view of -- of -- and I
want them to speak for themselves -- but counsel
who are sponsoring the economic experts
otherwise is that Dr. Yonkers can get done
tomorrow. We don't know that. We don't know
how much -- how much questions the government
may have. We don't know whether there will be
redirect of Dr. Yonkers, and to make that gamble
that he go tomorrow when he has been here two
weeks, I think is -- is unfortunate and not
right.

My suggestion is that we take the lunch
break, we take the direct of Dr. Knutson and
Dr. Knoblauch and then we have the
cross-examination of Dr. Yonkers. That would
give those of us who really need some time to
think about and focus on the testimony of
Dr. Knutson -- Dr. Knutson and Dr. Knoblauch an
opportunity to be very focused, we hope, in our
cross-examination; at least more focused. And I
think it's also fair to Dr. Yonkers.

JUDGE CLIFTON: Before I hear from
anybody else, let me say that I had been
planning, since I can remember, maybe even since
the first day -- I don't recall -- that today
would be the day for these two experts,
Dr. Knoblauch and Dr. Knutson.

Now, it was my understanding this is
their only day here. Let me first confirm
whether that is true. Mr. Ricciardi.

MR. RICCIARDI: Your Honor, I believe,
although I would need to talk to Dr. Knoblauch
on this, that they could be available tomorrow.
I know that they cannot be available on Monday.
So I need to get confirmation on that point that
you've asked me.

JUDGE CLIFTON: Okay. Would you find
that out, so that we know that so that that's in
the mix? And let me ask Mr. English a question
Mr. English, if you're going to use the
cross-examination time of Dr. Yonkers today to
make sure it's in, why would we not do that next
before we begin Drs. Knutson and Knoblauch?
MR. ENGLISH: Well, two things, your Honor. First, I was trying to also accommodate the other side a little bit here. And second, hearing the testimony from the -- from the witnesses and also making sure we get the whole direct. Because there's been additional direct, which we don't know but we assume there may be, would allow us then the time to -- in between, to focus that.

So it was two things, your Honor. It was simply an opportunity to try to move the ball forward, get their direct in, make sure that's done but also to make sure that it's their entire direct. And it would help us focus our attention on what that is, in order to prepare for the cross.

JUDGE CLIFTON: Okay. All right. Let me hear first from Mr. Ricciardi.

MR. RICCIARDI: Your Honor, I have been told that both Drs. Knoblauch and Knutson could be tomorrow although their flight schedule's in the afternoon, I believe, for both of them. Would you like to hear my thoughts as to how we proceed?

JUDGE CLIFTON: Yes, please.
MR. RICCIARDI: Thank you. I do think taking some time for lunch does make sense. So there's one point of agreement we do have. And your Honor is correct, we have scheduled the economists that are going to be presented by AIDA for a period of time. With regard to Dr. Yonkers and the carryover, that had absolutely nothing to do with us and trying to make that arrangement. It's just the way it's happened.

The way that makes the most sense is for us to actually have the lunch break -- hopefully it's not shrinking as I talk -- then have the presentation of the direct, followed by the cross of Drs. Knutson and Knoblauch so that we don't have an attenuated process when we don't have to have one.

And then I will represent to you that I have gone around to those people who are crossing in the room. I haven't talked to the government table. And we will make the representation that if, in fact, we start with Dr. Yonkers at 8:00, that he will be out of here by noon, period.

JUDGE CLIFTON: Okay. Mr. Carroll.
MR. CARROLL: I don't know if this is separate and if so, we can put this to another time. But this -- I'm talking now of Dr. Knutson's statement, which they were kind enough to give us today. It's about 35 or 36 pages.

We've been here a long time. All of us have got this. I think whatever you are going to do with -- this is very technical economic data, mainly, statements and rationales. It isn't the sort of thing I would hear him on the stand and get anything out of except that I read this.

And I'm wondering if we couldn't all, in this witness's case, wave two hours or three hours of time while he laboriously reads what we all have anyway, and as long as everyone has a reasonable chance for cross-examination to keep this thing moving.

JUDGE CLIFTON: If he wants to read his statement into the record, I will permit him, as I have every other witness. Mr. Vetne.

MR. VETNE: Yeah, just briefly. I think we ought to break for lunch. I think it's important to have continuity of witness direct
statements and cross-examination. I just didn't want this record to reflect something that I think is unfair, the fact that Dr. Yonkers has been here for a week and a half is somehow less fair to him.

Please remember that IDFA is a co-proponent. Proponents have the burden of proof. That's his job. The rest of us are just responding. I think that he is being disaccommodated, I think, is an unfair characterization.

JUDGE CLIFTON: I think Dr. -- I think Dr. Yonkers' plan to be here through noon on Friday was made before we failed to complete his testimony. I mean, we meant to get him in a long time ago and each day we meant to add him in if we could. And we've passed over and passed over and passed over him. But I think he had already planned to be here through noon on Friday regardless of when we heard his testimony. Am I correct on that?

DR. YONKERS: That's correct.

MR. ENGLISH: That is correct, your Honor. He is here through noon tomorrow.

JUDGE CLIFTON: Okay.
MR. ENGLISH: But --

JUDGE CLIFTON: Now, to me, if I'm a witness and I've been able to get my direct into evidence, I'm happy. And if the opposition to my position is willing to limit their cross-examination to when I have to leave at noon on Friday, I'm even happier.

But I can understand that what counsel want is to put Dr. Yonkers in to give you a little more time to digest what's in Exhibit 89 and 90, and I certainly understand that.

Mr. English.

(Exhibit 89 was marked for identification.)

(Exhibit 90 was marked for identification.)

MR. ENGLISH: Your Honor, I repeat that counsel for the other side may commit that they'll done by noon tomorrow, leaving us no time to do any redirect, if there is any, and leaving no questions from the government, conceivably. That's just not right. And the idea that somehow you know every witness who's come -- we hoped that Dr. Schiek would be on Monday. He had to wait an extra day. The idea
that a witness can only go one day when actually
we've just been told these two witnesses can be
here tomorrow if necessary --

Leaving aside who's the proponents,
Dr. Yonkers has been available multiple days.
And for whatever reason -- and, you know, I can
repeat my point that I think that
cross-examination has been unfettered, and as a
result this hearing has gone on very long.

Dr. Yonkers hasn't gone on. That's not
his fault. And we need to get him on the stand.
And a commitment that we start tomorrow morning
and he's done at noon tomorrow leaves the very
real possibility we'll get to noon tomorrow and
then we're the losers.

A commitment he can be done by noon
tomorrow is simply not sufficient given how long
cross-examination has gone in some witnesses.
And I just -- I have to insist that he get on
today. It's just -- you don't get to parachute
in and get out.

JUDGE CLIFTON: I've been thinking about
having him at least by noon tomorrow. Now you
have thrown another constraint in here.

MR. ENGLISH: Yeah, he'll been done by
noon tomorrow as long as he starts today. But if he starts at 8:00 a.m. tomorrow, he might not be done. That's the constraint.

    MR. BESHORE: Very quickly. I withdraw my vote to not have lunch now.
    JUDGE CLIFTON: Okay.
    MR. BESHORE: Beyond that, you know, I fully support the proposed order that Mr. English has proffered. And I would just make this note. There are two principal economists in support of proponents, Dr. Cryan and Dr. Yonkers.

    Dr. Cryan, there was a week between his direct and his cross. And there's been however many days -- I don't even want to count them right now -- between Dr. Yonkers' testimony being available and cross. Okay?

    Now, we're being the -- there are two principal economists on the other side. We're now being asked by the other side to have their statements this morning, have them on the stand and have immediate cross-examination. That's palpably unfair and we shouldn't proceed that way. We should have at least Dr. Yonkers worked in, as Mr. English has proposed.
JUDGE CLIFTON: Mr. Ricciardi and then Mr. Miltner, and then we'll go to lunch. But I'll tell you who the first witness is going to be. Go ahead, Mr. Ricciardi.

MR. RICCIARDI: Well, if you've made that decision, Judge, I won't add anything more. Let's go to lunch unless you need more information from me.

JUDGE CLIFTON: Okay.

MR. RICCIARDI: Because I am going to tell you right now -- again, I represent to you -- and I've gone around the room for those who are principal examiners -- we get him on at 8:00, he's out of here by noon.

JUDGE CLIFTON: Okay. Mr. Miltner, did you want to add anything else?

MR. MILTNER: Only that Dr. Knutson just reminded me his availability next week is none, so we do need -- that is critical.

JUDGE CLIFTON: Okay. All right. We'll take an hour for lunch. Then we'll begin Dr. Knutson's direct and cross and see how long it's taking us. But we will not stop with Dr. Knutson's direct. We'll do direct, and then we'll begin cross. And then I'll reserve
judgment on what happens after that.

MR. MILTNER: Your Honor, they're going to be on a panel.

JUDGE CLIFTON: Oh, they're going to go together.

MR. MILTNER: Yes.

JUDGE CLIFTON: Oh. Well, we may --

MR. ENGLISH: And, your Honor, that's the problem.

MR. STEVENS: Your Honor. Your Honor. Are we off the record or --

JUDGE CLIFTON: No, you're on.

MR. STEVENS: Garrett Stephen, Office of the General Counsel. I think now we're down to an issue of fairness, and I think everyone in this room that has been here has seen what has transpired. To have the economists go up after lunch and then have them cross-examined immediately after that, I can't see the fairness to that position relative to the other economy -- economists.

JUDGE CLIFTON: All right.

MR. STEVENS: There has been a long period of time between their testimony.

JUDGE CLIFTON: So you think every
An economist should be evaluated for a while before cross begins?

MR. STEVENS: Well, certainly more than just the time of their testimony, given the history of this proceeding. I hear the arguments of counsel, but the basic fairness issue is something I don't think you can really dispute. One -- one -- one set have testified and now cross-examination is delayed.

JUDGE CLIFTON: Okay.

MR. STEVENS: And this group that we're going with now, the cross-examination will occur right after their testimony. I just can't see those as being two equal opportunities. So I just note that for the record, your Honor.

JUDGE CLIFTON: Okay. Now, if my objective is to distance cross-examination from direct, we should have direct before we break for lunch.

MR. ENGLISH: It's 1:00. It's going to be an hour and a half.

JUDGE CLIFTON: No one likes that idea. No one likes that idea. All right. So your assertion that my schedule is unfair, Mr. Stevens, does not relate to my beginning the
direct examination of Dr. Knutson and
Dr. Knoblauch; it is based on when I begin their
cross?

MR. STEVENS: Yes, yes.

JUDGE CLIFTON: All right. I certainly
don't want to be unfair to USDA, who is
represented here by Mr. Stevens. I am here,
after all, on behalf of the Secretary.

So we'll take an hour for lunch. Then
we'll have the direct testimony of Drs. Knutson
and Dr. Knoblauch. Then we'll have the
cross-examination of Dr. Yonkers, and then we'll
begin the cross-examination of Drs. Knutson and
Dr. Knoblauch. We'll try to finish it all
today.

All right. Please be back and ready to
go at -- it's almost 1:00 -- at 2:00.
(A recess was taken from 12:54 to 2:04.)

JUDGE CLIFTON: All right. We're back on
record at 2:04. I'd like to correct something
that I said right before lunch. In my
crankiness, I said we would try to finish the
three experts today. I will be delighted if we
finish them today. But I do not mean by that
that I'm going to push you till 9:00 tonight.
I don't think that would be wise. So if we get close to 6:00 and cannot reasonably finish whoever we're working on, we won't. I will not work you to death, nor will I work the court reporters to death.

When I said it, I would have. But upon reflection, I will not. And then the other issue is, I am aware how meaty these statements are and how much they need evaluation. And so I will not rush you through that.

All right. Mr. Miltner, shall I have the witnesses come forward?

MR. MILTNER: That would be great, your Honor.

JUDGE CLIFTON: All right.

Drs. Knoblauch and Knutson -- Knoblauch and Knutson, would you please take the witness stand?

MR. MILTNER: I'll let them fight over who gets the cushy chair.

DR. KNOBLAUCH: I am deferring to my elder.

MR. MILTNER: For the record, that was Dr. Knoblauch.

JUDGE CLIFTON: Now, if you want to pour
water before you start, that's fine. If you're comfortable for now, that's also fine. All right.

Well, you have seen the rituals on how close you must be to the microphone. So you really will need to move it physically back and forth in order to talk right into it. I'd like first Dr. Knutson to state and spell his name.

DR. KNUTSON: Yes. I'm Ronald Knutson that's R-o-n-a-l-d, K-n-u-t-s-o-n. And it is pronounced Knutson.

JUDGE CLIFTON: And, Dr. Knutson, what type of doctorate do you hold?

DR. KNUTSON: I hold a Ph.D. in agricultural economics from the University of Minnesota.

JUDGE CLIFTON: Thank you. And now, please, Dr. Knoblauch.

DR. KNOBLAUCH: Wayne Knoblauch. The spelling of my last name is K-n-o-b-l-a-u-c-h.

JUDGE CLIFTON: All right. And I've been trying to pronounce it phonetically. But I see now it's Knoblauch.

DR. KNOBLAUCH: That's correct.

JUDGE CLIFTON: Very good. And what type
of doctorate do you hold?

    DR. KNOBLAUCH: A Ph.D. in agricultural economics from Michigan State University.

    JUDGE CLIFTON: I'll swear you in together.

    (The witnesses were sworn.)

    JUDGE CLIFTON: Each witness has answered, I do. Mr. Miltner you may proceed.

W. ANTHONY BOSTWICK

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

    DIRECT EXAMINATION

    BY MR. MILTNER:

    MR. MILTNER: Thank you, your Honor. I would like to start with Dr. Knoblauch. We have on the record your Ph.D., but could you give us just a brief professional and academic history for the record?

    DR. KNOBLAUCH: I have a bachelor of science degree from Michigan State University in agricultural economics, a master of science degree in agricultural economics also from Michigan State University. I joined the faculty of Cornell University in 1976 and have worked my way through the ranks.
I am now a professor in what is now called the department of applied economics and management but is physically in the same location doing many of the same tasks we did when we were the department of agricultural economics.

MR. MILTNER: And you've had the title of full professor since 1989, is that right?

DR. KNOBLAUCH: Yes, that's correct.

MR. MILTNER: And what is your primary area of expertise within agricultural economics?

DR. KNOBLAUCH: My specialty is in dairy farm management, business analysis, cost of production studies, almost anything relating to the operation and management of a dairy farm.

MR. MILTNER: And in your research and your academic work at Cornell do you also work with other professors on other projects dealing with the dairy industry?

DR. KNOBLAUCH: Yes, I do. I also teach classes, conduct extension work with farmers in New York and the Northeast.

MR. MILTNER: Have you had a chance to testify at a Federal Order hearing before?

DR. KNOBLAUCH: No.
MR. MILTNER: Have you had a chance to testify in any other types of proceedings before?

DR. KNOBLAUCH: I believe there was one state milk order hearing, but the other testimony has been in litigation.

MR. MILTNER: And rough numbers, how many cases do you believe you provided your -- your economic analysis for?

DR. KNOBLAUCH: Limited to deposition or trial testimony or --

MR. MILTNER: Yeah, let's start with deposition or trial testimony.

DR. KNOBLAUCH: Probably approaching a hundred cases.

MR. MILTNER: How about as a consultant outside of providing testimony?

DR. KNOBLAUCH: Probably 300 situations.

MR. MILTNER: Thank you. And if you could hand the microphone over to Dr. Knutson.

Dr. Knutson, I have the same series of questions for you. In addition to your doctorate degree that we have on the record, can you provide us a little bit of background for you academically and professionally?
DR. KNUTSON: Yes, I received my bachelor's degree from the University of Minnesota in 1961 or '62. And I received my master's degree from Pennsylvania State University a year later. And then I received my Ph.D. from the University of Minnesota in 1967. I went to Purdue University and was a faculty member there for four years.

I then went to the U.S. Department of Agriculture in a staff economist position in the agricultural marketing service of USDA. And then I went to a politically appointed position as the head of Farmer Cooperative Service in USDA.

In 1975, I went to Texas A&M University. I worked there in the area of dairy policy. I later became the -- became the director and founder of the Agriculture and Food Policy Center at Texas A&M University, which exists today, headed up by one of my former students.

The mission of the Agriculture and Food Policy Center is to do analyses for the Congress on the impacts of changes in farm policy.

Oh, I guess I should say that I am now a professor emeritus from Texas A&M. I retired a
few years ago, and I continue to work in the department of agricultural economics on a part-time basis on special projects.

MR. MILTNER: Okay. And what is your area of expertise within agricultural economics?

DR. KNUTSON: Well, as I said, initially started out at Purdue University in dairy area, direct marketing working on the development of regional cooperatives. I then continued at Texas A&M, but worked more generally in the area of agricultural policy based on my experience in the U.S. Department of Agriculture.

So I would have to say that during the bulk of my lifetime it's -- my professional life has been spent on a combination of dairy economics and agricultural policy.

MR. MILTNER: And you've had the opportunity to testify at Federal Milk Marketing Order hearings in the past?

DR. KNUTSON: I have. I've probably testified in -- oh, probably four different hearings, maybe five.

MR. MILTNER: And in addition to Milk Marketing Order hearings, have you had the opportunity to provide your analysis and
opinions in -- in other cases? And we'll start with trials and depositions, as we did with Dr. Knoblauch.

DR. KNUTSON: Yes, I -- probably not as many as he has. I've testified and given depositions in probably 15 different instances, probably two-thirds of them being in the dairy area.

MR. MILTNER: Have you had the opportunity to provide your consulting services and expertise in other proceedings?

DR. KNUTSON: Yes, I certainly have, an extensive number of proceedings over the years to a wide variety of interests in dairy and outside of dairy.

MR. MILTNER: Your Honor, we have copies of the CVs for both Drs. Knutson and Knoblauch. They are available on the front table here. I believe at least one of the statements refers to it as an attachment. They're extensive and lengthy, and so we haven't attached them. But anybody that cares to review one of the CVs is certainly welcome to do so.

I think I advised most of the attorneys representing other parties that they've been
available. And so they're at the front table, so -- I don't know if we want to -- in this type of proceeding we don't need to offer them as experts. Their testimony and their backgrounds are what they are but however the Court wants to proceed, we'll welcome -- we defer to the Court.

JUDGE CLIFTON: Is there anyone -- well, first of all, let me ask, do you, Mr. Miltner, want those CVs to be exhibits and on the website?

MR. MILTNER: I don't believe that's necessary, your Honor.

JUDGE CLIFTON: All right. Is there anyone who has anything to say about whether I should accept Dr. Knutson and Dr. Knoblauch as experts in the field of agricultural economics?

No one has a comment on that. I think you're clearly experts in the field of agricultural economics. And I accept each of you as such.

MR. MILTNER: And, your Honor, we've marked -- the Court has marked -- the judge has marked Dr. Knutson's statement as Exhibit 89, is that correct?

JUDGE CLIFTON: That's correct.
MR. MILTNER: And Dr. Knoblauch's as number 90?

JUDGE CLIFTON: Correct.

MR. MILTNER: Okay. We'd actually like to present Dr. Knoblauch's first. And before we -- we begin that, I want to just briefly have you comment on the scope of your opinions and testimony. So, Dr. Knoblauch, if you could take the mic.

Given your area of expertise, just in a sentence or two, what's the focus of your statement here?

DR. KNOBLAUCH: The focus of my statement would be on cost --

JUDGE CLIFTON: That needs to be higher. You're so tall.

DR. KNOBLAUCH: Sorry.

JUDGE CLIFTON: If you'll --

DR. KNOBLAUCH: I think that's as high as it goes.

JUDGE CLIFTON: You need to pull it very close to you and point it up. Yes. I think that will work right there.

DR. KNOBLAUCH: Okay. The purpose of my testimony and the topics covered in my testimony
relate to the cost of producing milk, cost of processing milk based on studies that have been conducted in our department at Cornell University.

MR. MILTNER: Okay. And if you could slide the mic over to Dr. Knutson just once more.

And, Dr. Knutson, given your background and area of expertise, what's the focus of your testimony?

DR. KNUTSON: My -- the focus of my testimony is on Federal Milk Marketing Order policy and the factors influencing Federal Milk Marketing Order policy on dairy marketing and cooperative marketing.

MR. MILTNER: And so, fair to say that, Dr. Knutson, your testimony, your area of expertise relates more directly to -- to the nuances of Milk Marketing Federal Order regulation and dairy policy?

DR. KNUTSON: It does, yes.

MR. MILTNER: And Dr. Knoblauch, your testimony, in accordance with your area of expertise, relates more directly to costs and efficiencies for both farms and plants, is that
correct?

DR. KNOBLAUCH: That's correct.

MR. MILTNER: Okay. So I guess we can go right into Dr. Knoblauch's statement then, your Honor.

DR. KNOBLAUCH: I will be reading into the record the document, Exhibit Number 90, entitled testimony of Dr. Wayne A. Knoblauch On Behalf of American Independent Dairy Alliance (AIDA).

The first section, Introduction and Qualifications. I am here today to present testimony at this hearing on behalf of the American Independent Dairy Alliance (AIDA). I am a Professor in the Department of Applied Economics and Management in the College of Agriculture and Life Science at Cornell University. I earned a Ph.D. in agricultural economics from Michigan State University in 1976. I have been on the faculty at Cornell University since that time. At Cornell University, I teach and conduct research and extension programs in dairy farm management. I have won numerous awards for my research, teaching, and extension programs. My curriculum
My testimony for AIDA in this hearing addresses three principal areas. First, drawing upon Cornell University research and USDA-ERS statistics, it discusses the costs of producing milk by both large and small dairy farmers. Second, I discuss the prices for milk actually received by dairy farmers basing my discussion on the continuing research done at Cornell concerning mailbox milk price. Third, my testimony addresses the research done at Cornell University to study the costs actually incurred by value-added processors, including some producer-handlers and the costs actually incurred by regulated fluid milk bottlers. Finally, I briefly discuss the costs of balancing incurred by producer-handlers.

Costs of Milk Production. For more than 50 years, Cornell has conducted surveys of New York dairy farmers on a wide range of topics, including the cost of producing milk.

Footnote 1, See the References and Citations Section at the end of my testimony for a listing of Cornell University Dairy Farm Business Summary publications that I relied on.
in preparing my testimony.

Data from the Dairy Farm Business Summary and Analysis program for 2006, 2007 and 2008 was analyzed by herd size. The Dairy Farm Business Summary represents the average of above average producers. For example, the producers in the study are above average in terms of milk production per cow and financial performance.

Not surprisingly, the results show that each -- I'm sorry, that in each of the most recent three years, as herd size increases, total cost of producing milk decreases. Small herds, those with less than 100 cows, averaged a total cost of $23.16 per hundredweight in 2008. For herds with greater than 800 cows, the total cost of producing milk decreased to $18.15 per hundredweight. The difference between small and large herd sizes is in 2008 of $5.01 can be attributed to improved rates of production per cow, and capital and labor efficiencies. Yet, despite these efficiencies, and of particular relevance to this hearing, it is important to note that the cost of production exceeds the uniform price for small herds in all years but not for large farms in good milk price years,
notably 2007 and 2008. While 2009 data is not available, it can be expected that for all herd sizes, the costs of production will by far exceed the uniform price.

The USDA, Economic Research Service cost of milk production data represents the costs for the average producer. Thus, their data shows costs that are higher per hundredweight of milk produced than the Dairy Farm Business Summary. The ERS average data demonstrates that even when measured against the Class I price, the cost of production exceeds the Class I price by 5 to 8 dollars per hundredweight. See the attached graph for actual Dairy Farm Business Summary and ERS cost of production data in comparison to milk prices.

The Cornell data and other data from other studies, most notably the United States Department of Agriculture, Economic Research Service studies, show that scale economies virtually disappear after 1,250 cow herd size is attained. This is regardless of geographic region of the United States. See especially USDA, ERS Publication Number 47, September 2007. But nevertheless, even for those producers with
these larger, more efficient herds, their cost of production regularly exceeds the uniform prices and even the Class I prices of the orders. Given this fact, dairy farmers, regardless of the size of their herd, cannot rely on simply marketing their raw milk to ensure long-term economic viability of their farm operations.

Milk price differences. The case that Federal Milk Marketing Orders provides uniform milk prices for all producers is just plain wrong. Cornell University compiles period reports and surveys of producer paychecks, which are sorted and analyzed to provide a clearer picture of producer returns. These reports demonstrate that even within the structure of Federal Orders, farms will be paid differently based on component levels shipped in Multiple Component Pricing orders, somatic cell counts in these orders where that is accounted for, and the Producer Price Differential. As you can see from the attached milk check data, over-order premiums and deductions from milk checks differ significantly across farms. See Comparing Your Milk Checks, Stephenson.
In any year, there is about a $2.00 difference from high to low within New York state alone based on components, and this is not taking colored breeds with higher milk components out of the equation.

JUDGE CLIFTON: Let me ask you there. You said that is not taking them out and the statement says, and this is taking them out.

DR. KNOBLAUCH: If I said that, I apologize. It is. And this is taking breeds with higher milk components out of the equation. They were removed.

JUDGE CLIFTON: All right.

DR. KNOBLAUCH: So if I included not, I misspoke.

JUDGE CLIFTON: All right. Just read that sentence again for us, please.

DR. KNOBLAUCH: In any year, there is about a $2.00 difference from high to low within New York state alone based on components, and this is taking colored breeds with higher milk components out of the equation. There is also a $2.00 spread in what we call the Net Marketing Margin, which takes the Producer Price Differential plus all premiums minus all
expenses (including hauling). The net marketing margin is a good measure of actual differences among similarly situated farms because a farm could always get a higher Producer Price Differential by shipping their milk to Boston in Order 1 or to Miami in Order 6, for that matter. However, the hauling costs could more than offset the higher Producer Price Differential. Taking these marketing decisions into account, along with components of producer milk, this research data makes the point that producers do not receive equal payments under the current Federal Order system.

What would producers gain by having producer-handlers pooled? In 2008, about 39 percent of the producer receipts in Federal orders were used in Class I sales. The producer-handler roll in 2008 was about 1.5 percent of Class I sales. If we assume that the average Class I differential that would have been paid by producer-handlers was between $2 and $3 per hundredweight, then the average statistical uniform price would have increased from $18.24 per hundredweight to 18.25 to $18.26, a mere 1 to 2 cents per hundredweight.
These increases in the uniform prices due to the full regulation of producer-handlers would neither offset the differences already existing among producer mailbox prices nor would it change the existing spread among producers. Producers are not losing significant revenues because producer-handlers are not contributing to the pool. Just to put this in perspective, this is well below the 4 to 5 cents of administrative costs required in most Federal orders that producers would have to pay.

Let's talk about the pay price to the producer. The cooperative set the prices to the extent that they are above minimum price, and also have add-on charges and deductions which they charge back to the producers. Thus, the 1 to 2 cents might never even go into producers' pockets in any event.

Value-added processors. My Cornell University colleagues, Chuck Nicholson and Mark Stephenson, conducted a study of producers who operated plants to determine the viability and profitability of their operations. In this study, (RB 206-07) Nicholson and Stephenson refer to the business as Value-Added processors
rather than Producer-Handlers, because there are several farms which are bottling and selling fluid milk but also many farms making manufactured products. We decided to conduct a study of these operations in New York, Vermont, and Wisconsin in 2006. There were 27 operations in total that were studied. Some of them were goat or sheep farms, but most were traditional dairy farms. Some bottled and solid fluid milk but most made cheese or other manufactured products. Still, there were six operations bottling cow's milk which had producer-handler status involved in the study.

Enterprise accounting was used to separate the income and expense of producing milk from processing and marketing of finished products. When processing net income (which includes the cost of the milk produced) was plotted against total processing receipts, a distinct pattern was observed. The report shows a regression line through these data points which indicates that regardless of product produced or type of milk (cow, sheep or goat) a value-added processor needed to receive about $100 per hundredweight in total returns in order
to break even.

Fluid milk processors in this study were found to average $2.38 in process costs (not including milk price) per gallon. There was only one farm in the study that made a modest return on both milk production and processing. Most made a bit -- let me start again, please. Most made a bit of profit in one side of their operation or the other. If part of the rationale for a Producer-Handler exemption is to allow them some room to compete with larger specialized fluid plants, it is obvious from this study that that need still exists.

The additional burden of contributing equalization payments to the pool and the associated paperwork would certainly put some folks out of business. And, this really comes without the usual Class I benefit of performance (balancing) for most producer-handlers.

Cost of processing. Admittedly, producer-handlers in the Value-Added study were smaller sized operations. However, another Cornell University study clearly shows that larger plant size and higher plant capacity utilization increased plant labor productivity.
Furthermore, both factors also directly impact plant cost per gallon. The total effect of operating a larger plant, considering both the direct effect on cost per gallon and the indirect effect on costs through increased labor productivity, was substantial if plant size changed significantly. See EV -- I'm sorry. See RB 97-03, Erba, Aplin, and Stephenson.

For example, increasing from 2 million gallons (17.24 million pounds) per month to 3 million gallons, (25.86 million pounds) decreased plant cost per gallon by 4.1 percent. Increasing from 3 million gallons per month to 4 million gallons, 34 -- (34.48 million pounds) per month further decreased plant cost per gallon by 2.7 percent. Given their analysis was based on costs exclusive of depreciation, the cost advantage of larger plants when including depreciation is undoubtedly even larger because the investment per gallon is lower in larger plants. This provides evidence that plants in the 15 to 30 million pounds of milk per month are still finding substantial returns to scale and have not yet reached the flat portion of the cost curve which occurs after the
30 million pounds of milk per month. The assertion that fluid milk bottling plants reach a level of efficiency at 3 million pounds of Class I volumes each month sufficient to compete on a level playing field with larger regulatory -- regulated bottlers is simply untrue. When we further consider that this study was completed over 12 years ago and it is likely that the scale economies have moved to even larger volumes since then. Producer-handlers, even those processing volumes of milk at the upper ends of the levels estimated by NMPF in its economic testimony are simply not in the range of the scale to compete with equal milk costs with large, fully regulated plants.

Balancing costs. Producer-handlers must balance their own milk supplies with demand for their fluid products. If a producer-handler produces more milk than it is able to sell as a finished product, the disposal of surplus milk is either through outlets that the producer-handler might possess or sales to another outlet at a negotiated price -- usually the lowest class price -- not the statistical
uniform price. We tend to think of the uniform price as the opportunity cost that a producer-handler foregoes for the privilege of selling at a higher Class I level, but that is not the case for sales of milk to balance their production. The significant cost of balancing is placed on the producer-handlers. For example, the U.S. average statistical uniform price in 2008 was $18.24 per hundredweight, but the Class IV price only averaged $14.65 that year. The penalty to a Producer-Handler for selling milk at the Class IV price was therefore $3.59 per hundredweight.

For example, if 20 percent of the producer-handler's milk was sold to balance demand, it is receiving a penalty of at least 72 cents per hundredweight of milk produced (3.59 times 0.20) versus operating as a plant with 100 percent Class I sales.

Conclusions. The results of Cornell University research showed that each of the most recent three years, as herd size increases, total cost of producing milk decreases and decreases significantly, but plateaus at approximately 1,250 cows. This is consistent
with studies performed by others, most notably, the USDA Economic Research Service. Taken in tandem, the data from the DFBS and the ERS demonstrate that the total costs of production across all herd sizes exceeds the FMMO blend and Class I prices.

Milk check research data clearly makes the point that producers do not receive equal payments under the current Federal Order system. This is true even if one ignores the differences in farm-to-farm component payments. Over-order premiums and other marketing decisions result in milk checks that vary substantially between producers in the same Federal Order. If producer equity is a goal of Federal Milk Marketing Orders, then attacking -- I'm sorry, then lack of attaining that goal has little to do with the producer-handlers.

Value-added research simply -- I'm sorry. Value-added research clearly implies that producer-handler status is a small step in the direction of leveling the playing field with large specialized fluid plants.

As both farms and plants get larger, producer-handler operations still function at a
comparative disadvantage to larger fully
regulated plants. Even the largest farms do not
generate consistent returns from simply
marketing raw milk to ensure profitability, and
assuming that those large farms elect to operate
producer-handling -- producer-handler bottling
plants, economies of scale from plant size are
not fully realized at the levels of volumes that
even the larger producer-handlers operate.

Producer-handlers can incur large costs
in balancing milk supplied to meet their own
customer demands. These costs are incurred by
the producer-handler and not by the pooled
producers in the order.

Then there is a References and Citations
section. Should that also be read?

MR. MILTNER: I don't know that reading
the references into the record is necessary
because they're listed on the exhibit, which
we'll move its admission at the appropriate
time, Judge.

Dr. Knoblauch, is there anything else
that you want to add at this time? I didn't
mean to stop you in your statement.

DR. KNOBLAUCH: No, I have read the --
read the statement.

    MR. MILTNER: Okay. Very good. Now, before we have Dr. Knutson read his statement -- and I'm not going to finish the direct exam here, but I did want to point out that those items listed under References and Citations, Dr. Knoblauch, are most of those available online at the Cornell University website, those that are referred to as research bulletins and the like?

    DR. KNOBLAUCH: Those that are from Cornell, yes.

    MR. MILTNER: And the others are USDA data references?

    DR. KNOBLAUCH: Yes. And those are available online.

    MR. MILTNER: And, your Honor, as had been done earlier in this hearing, copies of the documents were set out on the front table. Many of them have left, and I assume they're around the room. But I believe there were at least three copies of each of those documents for people to review and they've been up there for at least a good portion of the day. And one thing I did want to point out.
One of the documents that was put out there and made available was a document called Comparing Your Milk Checks by Dr. Mark Stephenson, which is referred to in the statement. On page 3 of your testimony, Dr. Knoblauch, there's a line at the end of the first paragraph that says, as you can see from the attached milk check data, over-order premiums and deductions from milk checks differ significantly across farms.

Now, at the end of your statement is a chart but that doesn't have the milk check data on it, does it?

DR. KNOBLAUCH: No. No, it does not. The milk check data is not stapled to my statement. It should have been or currently is on the front table.

MR. MILTNER: It was up there. But that's -- what I'm holding up is a copy of Comparing Your Milk Checks, is that right, and it has the tables at the end?

DR. KNOBLAUCH: Yes.

MR. MILTNER: Okay. Because he's referred to it in his statement, as being, see from the attached data, I've made 30 copies of that report only, and I'll be happy to
distribute them right now, your Honor.

JUDGE CLIFTON: Yes, let's mark that --
I'll let you distribute them in a moment, but
we'll call that Exhibit 91.

MR. MILTNER: That would be fine. Thank
you. And now let's go off record.

(Exhibit 91 was marked for
identification.)

(Off the record.)

JUDGE CLIFTON: We're back on record at
2:44. With regard to Exhibit 90, I would like
the last sentence stricken on the record copy.
And, Dr. Knoblauch, I would like you to initial
that before you leave the room. And the person
who keeps the record copy is seated at the
second table to our right on the far end. And
with regard to Exhibit 91, that has now been
distributed. Is there any objection to Exhibit
91 being admitted into evidence? There is none.
I hereby admit into evidence Exhibit 91. And
we'll deal with the Exhibit 90 and the Exhibit
89 wherever you want to, Mr. Miltner.

MR. MILTNER: That would be fine, Judge.
And just to be sure, I'm not sure what you said
but what I heard is we're striking the last
sentence in Exhibit 90. But I want to make sure it's the last sentence in the first paragraph of Exhibit 90.

JUDGE CLIFTON: That's correct. And it reads: My curriculum vitae is attached to this testimony.

MR. MILTNER: Okay. Thank you. And then Dr. Knutson, if you would want to proceed with your statement, please.

DR. KNUTSON: Thank you. Introduction and qualifications. My name is Dr. Ronald D. Knutson. I am a Professor Emeritus at Texas A&M University and reside at 1011 Rose Circle in College Station, Texas. At Texas A&M, I served for 28 years as a professor and for 13 years as Director of the Agricultural and Food Policy Center, whose primary tasks involved completing studies of the impacts of proposed policy changes for the U.S. Congress. Prior to accepting the Texas A&M position, I was the Chief Economist in USDA's Agricultural Marketing Service and the Administrator of its Farmer Cooperative Service. Throughout my nearly 50 years as a professional agricultural economist, one of my primary research areas has been dairy
marketing and policy. In this capacity, I served as the Chairman of two USDA Milk Pricing Advisory Committees; one evaluated the regional cooperative developments in the late 1960s and the early 1970s, Minnesota-Wisconsin manufacturing milk pricing series, and the implication for Federal Milk Marketing Order pricing. The second USDA study evaluated pricing and classification options for Federal Milk Marketing Order Reform. And I would propose striking the words on attachment my professional resume, as well.

JUDGE CLIFTON: Let's do that right now. The end of the first paragraph on Exhibit 89, that sentence will be stricken. And Dr. Knutson will initial that before he leaves. So what is being stricken is: I have attached my professional resume.

DR. KNUTSON: Preparation for testimony. I have been engaged by the members of the American Independent Dairy Alliance (AIDA) for the purpose of analyzing the market position of producer-handlers, to evaluate the petitions -- positions taken by the petitioners and their impacts, and to evaluate the alternative
proposals presented in this hearing by AIDA members. To accomplish this task, I have reviewed and analyzed the -- analyzed the National Milk Producers Federation (hereinafter NMPF) and the International Dairy Foods Association (hereinafter IDFA) petitions. I have reviewed the Federal Register for this hearing dated April 9, 2009, and the Federal Register Final Decision dated December 14, 2005, regarding the regulation for producer-handlers for the Pacific Northwest and Arizona-Las Vegas orders, hereinafter referred to as the 2006 producer-handler decision. I have reviewed and analyzed much of the data and information related to the hearing that has been posted by the Dairy Programs/AMS/USDA, and relied on this data for substantial portions of my analysis. In addition, I have reviewed and analyzed AIDA's Requests for Denial of Proposals to Eliminate Producer-Handler Exemption and have analyzed and evaluated IADA's alternative proposals. Finally, I surveyed the members of IADA to become familiar with their operations and to obtain data that I could utilize in completing my analysis and in developing my testimony.
JUDGE CLIFTON: And, Doctor, those initials, again, for the American Independent Dairy Alliance, would you again read those into the record. You referenced to them just now twice.

DR. KNUTSON: AIDA.

JUDGE CLIFTON: Thank you.

DR. KNUTSON: Summary of conclusions reached. I have concluded that it is time for a Federal Order policy reality check in the context of today's milk industry and how it operates. This reality check is particularly important because this hearing decision is establishing national policy for Federal Order regulation and for the dairy industry. The NMPF and IDFA proposal that is before you would, for the first time I am aware of, effectively eliminate an economic marketing option for milk producers having over 250 cows. As a matter of national dairy and Federal Order policy, such a regulatory change would not only be inconsistent with the Federal Order policy since its creation under the Agricultural Marketing Agreement Acts of 1937, as amended (the AMAA hereinafter); it would be also be inconsistent with the American
economic free-enterprise system as established by our forefathers.

From a national perspective, the producer-handler organizational form, subject to the regulatory limits that have been established by USDA, is not and never has created disorderly marketing conditions. It is not possible from a macroeconomic national perspective, for producer-handlers with only 1.46 percent of the fluid market, to have sufficient market power to become disorderly under any reasonable definition of the term. On both the cooperative and processor sides of the market, there are large concentrations of market power that make the producer-handlers' share minuscule by comparison.

There is no realistic threat that producer-handlers will ever achieve such a scale of operation that they would become a source of disorder within the meaning of the AMAA. If Federal orders were giving producer-handlers the substantial advantages that have been and are being alleged, there would surely be a substantial influx of new producer-handlers to take advantage of these opportunities. There is
no such influx. In any case, and in the interest of preserving competition and choice in our economic system, the producer-handler status is a valuable option for all producers based on the economics of their operations.

The activities of producer-handlers do not violate the purposes of the Federal orders as specified in the AMAA. Surely, with only 39 percent of the milk supply being used in Class I, consumers are assured of an adequate supply of pure and wholesome milk. Surely, cooperatives have effectively utilized the variety of methods available to them for addressing the farm income situation. It is equally certain that the NMPF and IDFA proposals do not and could not address the farm income situation. The principal assertions relied upon by the NMPF and IDFA to establish disorderly marketing conditions on a national scale are not substantiated by the data. The data presented and cited herein clearly first while -- indicate; First, while Federal Orders set minimum prices, in most instances these minimum prices do not exist in the marketplace, and little milk or no milk is traded at these
minimum prices. The Federal Order minimum prices are masked in the market by premiums, charged by cooperatives, that frequently exceed the minimum price by $2.00 per hundredweight or 23 cents per gallon. While Market Administrators calculate a blend price, few producers receive that price even after taking into account variation in the values of milk components. In fact, it is not unusual for producers who are members of cooperatives to receive less than the blend price, for producer pay prices to vary substantially among producers within the same cooperative. Any disorder that may exist in Federal Order markets is far more likely to be caused by the fact that raw milk prices have little or no relation to Federal Order prices than it is to be caused by the unsupported assertion that producer-handlers create disorder that adversely affects price and income objectives of the AMAA.

In this environment, dominated by the NMPF cooperative members, it is asserted that the appropriate transfer price is the difference between the Federal Order blend price, which does not exist in the market, and the Federal
Order Class I price, which also does not exist in the market. This reasoning defies economic logic not only because these Federal Order prices are not market prices but also because in the real world, transfer prices are based on costs.

Any decision to change national producer-handler policy presents different issues than those previously considered by US -- the USDA. A national policy decision requires an analysis of the entire milk market and the role of producer-handlers in that market. My analysis clearly and factually indicates:

First, producer-handlers are frequently producing unique and growing niche market products -- products such as organic, kosher, and grass-fed milk, which inherently is much more costly to produce. Second, some producer-handlers continue the tradition of delivering milk to consumers. Third, producer-handlers are forced to adjust their production patterns to minimize surplus production, which would be sold at a substantial loss. Fourth, the managers of producer-handler options have to divide their attention between
both the farming and the processing sides of the operation, which reduces the cost advantages that would otherwise be associated with specialization.

JUDGE CLIFTON: Doctor, please reread that fourth item.

DR. KNUTSON: Fourth. The managers of producer-handler operations have to divide their attention between both farming and the processing sides of the operation, which reduces the cost advantages that otherwise would be associated with specialization. Fifth, producer-handlers have substantial sunk capital investment costs in their production, processing, and distribution. Ignoring these realities leads to conclusions about producer-handlers that are without foundation.

In the 1962 Nourse Report to the Secretary of Agriculture -- excuse me, the 1962 Nourse Report to the Secretary of Agriculture took great care in defining the orderly marketing objective of Federal Orders. Its definition describes the characteristics of orderly markets in economic terms, including equalizing the market power of the buyers and
sellers, assuring adequate and dependable milk supplies, maintaining economic order in the industry, ensuring equitable treatment of all parties and maximum freedom of trade with proper protection against loss of outlets. The emphasis here is on maintaining a regulatory balance among all parties in the marketplace and treating all parties equitably, and by implication, not necessarily equally. Certainly the Nourse Report concept of orderliness would not support a national policy that put minority independent producer-processor interests at a competitive disadvantage or deny producers the option of becoming fluid milk processors.

Proposals 23, 24 and 25 are alternatives to the elimination of the producer-handler designation that are workable, consistent with other Federal Order regulations, and will not have the effect of damaging existing businesses, or unreasonably restricting future choice. These options include exempting all producer-handler's own-farm production with down-allocation, exempting all producer-handler milk sold through home delivery and handler-controlled retail outlets, and by
establishing individual handler pools for all handlers across all Federal orders.

The remaining segments of my testimony presents facts that will substantiate the conclusion that producer-handlers are not a source of disorder in milk markets and will discuss the implications of current rulemaking process -- of the current rulemaking process for Federal Order policy. I will then explain and analyze how IDA -- AIDA proposals would address the issues that gave rise to this hearing.

JUDGE CLIFTON: Let's do those initials one more time.

DR. KNUTSON: IADA.

JUDGE CLIFTON: You really want it to start with an I?

DR. KNUTSON: Excuse me, AIDA. I'm sorry.

JUDGE FELSON: Thank you.

DR. KNUTSON: There's too many initials.

Overall status of producer-handlers in the milk industry. In the context of a consolidated national dairy industry where multi-state cooperatives and national processors and retailers exert significant market control,
producer-handlers are small, both in their relative size and in the aggregate. By regulatory requirement, they are operations that control all of their milk production facilities and all of their milk processing facilities. Certainly, the size of producer-handlers and the producer -- and -- excuse me.

Certainly, the size of producers, handlers, and producer-handlers has grown over the years. Table 1 provides a factual comparison of these growth trends. It was developed from data that are contained in the record. However, in the absence of complete records, for the years 1969 to 1992 the producer-handler volume data were estimated by multiplying the Class I Federal Order sales times the monthly percent of sales by producer-handlers as posted by Dairy Programs in preparation for this hearing. This sales estimate was then divided by the number of producer-handlers from the same Dairy Programs source.

The data in Table 1 indicate that the average producer size increased by 4.3-fold from 1969 to 2001 and 5.7-fold from 1969 to 2008.
The average handler size increased by nearly 9.2-fold from 1969 to 2001, by nearly 10.3-fold to 2006, and then, with reduced sales, decreased to 9.3-fold in 2008. The average producer-handler increased by 4.5-fold over the 1969 to 2001 period, by nearly 8.3-fold to 2005, and then decreased to 6.1-fold in 2008. As would be expected, because producer-handlers are both milk producers and processors, the average producer-handler increase in size lies between that of the producer size increase and the processor size increase.

These data clearly indicate that producer-handler growth is constrained, which is not what the NMPF and IDFA would like USDA to believe. The fact that producer-handlers must maintain sole ownership and control over their operations places a de facto limit on the size of producer-handlers that is dictated by the realities of their integrated operations. This fact is forever -- corroborated by the posted table titled, Federal Order Small Plant Structure Information for May 2008 that was appended to and relied upon by the NF -- NMPF petition for this hearing. Table 2 abstracts
from this table to clearly indicate that producer-handlers and other exempt plants have been greatly constrained in growth relative to conventional regulated pool distributing plants. Of the 45 producer-handlers in May 2008, 40 have a sales volume of less than 2 million pounds, and only 5 had a volume of over 2 million pounds. All -- all of the exempt plants had a volume of less than 2 million pounds. No producer-handlers even approach the increasingly common 30 million-pound size that characterizes the cutting edge of today's fluid milk processing sector. The over 30 million size category is not broken out in the May 2008 table.

In sharp contrast, only 46 conventional pool distributing plants had a volume of less than 2 million pounds. And I have a correction here. Strike 507 and insert 210. And another insert in the next line, strike 507 plants and insert 201.

So let me read it from the start as it should be. In sharp contrast, with only 46 conventional pool distributing plants that had a volume of less than 2 million pounds and 210
that had a volume of over 2 million pounds. Of these 210 plants, 73 had a volume of over 20 million pounds. While it can be presumed that more volume and less competition are preferred by the ownership of these 73 plants, it is difficult to imagine the producer-handlers having sufficient market power to create disorderly market conditions. Excluding competitors surely is not a role that Federal Orders should either sanction or support.

If, as the NMPF and IDFA suggest, producer-handlers are benefiting so much from the producer-handler exemption, it is not apparent in their numbers, which have declined by 53 percent since 2001, from 79 to 37 producer-handlers in March 2009.

Figure 1 and the following Federal Order statistics indicate the number of producer-handlers for selected years:

October 1969, 421; October 1992, 137;
December 2001, 79 and a 42 percent decrease from 1992 in nine years, which is 4.6 percent annually; December 2005, 46; December 2006, 43, December 2008, 47, and a 41 percent decrease from 2001 in seven years, which is 5.8 percent
annually; March 2009, 37 and a 21 percent decrease in three months.

These data indicate that the number of producer-handlers has declined successively since 1960 from 421 to 37 in March 2009. It is also informative to note that the rate of decrease in producer-handler numbers has accelerated from 4.6 annually from 1991 to 2001 to 5.8 percent annually from 2001 to 2008. Then in three months from December 2008 to March 2009, the number of producer-handlers decreased by 21 percent. This rapid and substantial decline indicates that a large number of producer-handlers closed their doors, given the adverse economic climate for milk production and the lack of sufficient producer-handler margins in processing and distribution to absorb the losses in production.

As a consequence of the 2006 producer-handler Federal Order decision and proposals by the NMPF and IDFA for this hearing, it appears that eliminating producer-handlers has become a principal national Federal Order dairy policy objective of these petitioners. Also, it is important to note that the Dairy
Program has not published, annually, a complete set of statistics on the number and sales of producer-handlers, apparently because producer-handlers were not considered to be sufficiently important in the markets for milk.

While the NMPF and IDFA might admit to the fact that the number of producer-handlers has decreased, they imply that producer-handler sales have increased. This is not apparent from the data, as illustrated in Figure 2 utilizing the Dairy Programs statistics. The estimated producer-handle sales volume suggests that producer-handler -- suggests that producer-handler sales volume hit a peak of 853 million pounds in 1992. Since 1992, the producer-handler sales volume has declined. Since 2000, which -- for which the Dairy Program has posted annual producer-handler volume data, producer-handler' sales volume has seen no increasing trend. While it might be asserted that since the Pacific Northwest, Arizona, Las Vegas Federal Order decision, the producer-handler volume may have rebounded, that assertion would be based on only one year of data. The indicated decline in the number of
producer-handlers in 2009 would suggest a potential reversal of the increased volumes in 2008.

The percent sales by producer-handlers shows the same declining trend. It is true that producer-handlers' sales -- share of sales surged in 2006. There was another surge --

JUDGE CLIFTON: Now, let me ask you. What number do you want there at the end of that sentence, the sentence that starts: It is true?

DR. KNUTSON: It is true that producer-handlers share of sales surged in the 1960s. There was another surge from 1.6 percent of route sales in 1980 to 1.9 percent in 1992. However, by 2008 the producer-handlers' share had declined to 1.46 percent. If the producer-handlers' exemption was and is of such great benefit, why is it that their market share has not increased?

I have surveyed each of the producer-handler members of the AIDA group. While the AIDA members are highly diverse, and I will say more about their factual characteristics subsequently, there are seven substantive statistics that stand out: First,
relative to cooperatives and processors that the
NMPF and IDFA represent, they are all small
businesses that run processing plants and market
the milk they produce.

Second, they each have their own market
niches that reflect ever-increasing diversity of
the consumer market, which no longer treats milk
as a homogenous commodity. In performing this
important function of appealing to consumer
diversity, they build and expand the market for
milk, compete more effectively with nondairy
products, and serve particular consumer tastes
and preferences, such as for organic products.

Third, those producer-handlers that home
deliver are often the last vestige of home
delivery service to customers who need this
higher level of service, and can afford to pay
for it. With an ever-increase -- ever-aging
population, this niche market service can become
more important in the future.

Fourth, they sometimes operate their own
stores, a further complex step in marketing
beyond producing and processing milk.

Fifth, emphasis in marketing to wholesale
outlets is often on smaller accounts and
certainly is in smaller volumes per account. This emphasis is sometimes dictated by the reality of supermarket retailers who limit shelf space allocated to other than their conventional major homogenous milk brands.

Their consumer price -- six, excuse me. Their consumer prices generally far exceed those of conventional products as dictated by higher production costs for niche markets, higher processing costs, higher distribution costs, and by the pricing practices of the retail chains.

Seven, the minority of producer-handlers that are tagged as being price competitors by their rivals are viewed as -- are viewed as such, because they are penetrating highly concentrated monopolistic markets. In this case, competition is welcomed by both the wholesale and consumer customer base. Most certainly this is not the type of competition that Federal Orders were designed to regulate as a matter of national policy. Quite the opposite, Federal Orders were created at a time when milk markets were highly monopolistically controlled by a few major proprietary milk processing firms. Competition is one of the key
factors that gets the public a sufficient supply
of milk at a reasonable price, a key objective
of the AMAA.

Assertion versus Reality: Who sets the
raw milk price? It is often asserted that
Federal Orders set raw milk prices. The NMPF --
excuse me, the NMPF petition makes this
assertion when it states on page 4 that the
regulated competitors of producer-handlers pay,
in quotes, the -- pay the Class I price for the
same milk, unquote, as producer-handlers
produce. In reality, the price paid by the
regulated competitors of producer-handlers is
not the Federal Order Class I price. Instead it
is generally the Class I price plus a
substantial premium that is set by large
cooperatives. The Dairy Programs/AMS/USDA refer
to this price as the announced cooperative Class
I price, which -- which it regularly reports in
its Dairy Market News weekly reports and
annually in its Dairy Market Statistics
publications. Premiums exist because
cooperatives have sufficient control over the
milk supply that they are able to demand and
extract premiums from even the largest milk
processors.

Table 3 indicates that cooperative premiums over Federal Order Class prices increased from an average of $1.11 per hundredweight in 1999 to $1.83 per hundredweight in 2006, then declined to $1.81 per hundredweight in 2007, and then increased to $2.48 per hundredweight in 2008. Clearly, the trend in Class I premiums is in an upward direction, and the trend more than just reflects higher energy/transportation costs.

JUDGE CLIFTON: Before you go on to the next point, that point, and it's labeled as paragraph 24 on page 11, is entirely about Class I prices and no other price, is that correct?

DR. KNUTSON: Exactly.

JUDGE CLIFTON: Okay.

DR. KNUTSON: Table 4 indicates that for the flush production month of April, the size of the premium is highly variable from city to city and over time. For example, in April of 2009, Federal Order premiums ranged from 50 cents per hundredweight in Phoenix to $3.14 per hundredweight in Chicago. Premiums are lower in
western markets largely because of competitive factors associated with California regulation and production. In the rest of the United States, where Federal Orders and cooperatives dominate -- excuse me -- the April 2009 premiums for plants located in the cities indicated ranged from $1.50 per hundredweight in Boston to $3.14 per hundredweight in Chicago.

The data in Table 4 also indicates a clear trend toward higher premiums for each of the cities. Surprisingly, in April 2009, for a number of markets such as Chicago, Dallas, Denver, Kansas City, Oklahoma City, and Seattle, cooperatives were able to increase premiums in despite of surplus conditions, falling milk prices, and falling energy prices. To an economist this is a clear indication of substantial cooperative market power. It is also an indication that Federal Order markets are not disorderly or chaotic in terms of milk suppliers' ability to negotiate an advantageous price. If producer-handlers were a significant force causing market disorder, these premiums would either be unstable or would not have increased in 2009, or would not exist. The data
indicate that cooperative premiums do exist; that these premiums are stable and that they increased in 2009 in spite of surplus conditions.

In addition to premiums, often fluid milk processors are being forced to pay cooperatives huge give-up charges in order to have access to milk supplies used in their Class I bottling operations. While give-up charges are not publicly reported, professor Bob Cropp at the University of Wisconsin writes that when milk supplies are tight, give-up charges as high as $5.00 per hundredweight or more have been experienced to get milk released by fluid use -- for fluid use by manufacturers. Economists believe that a contributing factor to the Chicago higher premiums, indicated in Tables 4 and 5, reflects the influence of give-up charges by manufacturing plants located in the Upper Midwest Federal Order. The Table 5 data for 2008 -- for October 2008, indicating a premium of $3.48 per hundredweight compared with $2.80 per hundredweight in April 2008 substantiate this point. Ultimately, the cost of these give-up charges is borne by consumers. In
addition, huge premiums and give-up charges suggest that they are not being well-served by current Federal Order marketwide pooling arrangements. The option of individual handler pool -- pooling would substantially reduce the incentives for give-up charges and premiums. In other words, it would result in Class I prices that exist to more closely approximate Federal Order Class I prices.

The fact that Federal Orders do not set the price that producers pay for milk --

JUDGE CLIFTON: Excuse me. Read that sentence again.

DR. KNUTSON: The fact that Federal Orders do not set the price that processors pay for milk, indicates that price instability and competitiveness factors in milk markets are dominated by contesting between dominant cooperatives and processors, not by the insignificant market shares held by producer-handlers who, as a general rule, are not in a position to compete on the basis of price. In addition, the very existence of premiums and give-up charges build in extra costs on processors for milk, distorts the price
surface set by Federal Orders, and enhances consumer resistance to paying high prices for conventional homogenous and undifferentiated milk products. As a matter of national policy, it would be incongruous to discriminate against producer-handlers by forcing them to pay the difference between the uniform Federal Order blend price and the Class I price, while ignoring the destabilizing effects and -- the stabilizing effects and consumer price-enhancing effects of cooperative premiums.

JUDGE CLIFTON: Let me interrupt you there, Dr. Knutson. You are on page 13 and you're about to begin a new section. And because this is so concentrated, I'd like us to take a 10-minute break right now.

DR. KNUTSON: That would be fantastic.

JUDGE CLIFTON: It's almost 3:30. Please be back and ready to go at 3:40.

(A recess was taken from 3:29 to 3:41.)

JUDGE CLIFTON: All right. Let's go back on record. All right. We're back on record at 3:43. Returning to page 13 of Exhibit 89, we had completed paragraph 28. Dr. Knutson, you may resume.
DR. KNUTSON: Assertion versus reality:

Who sets the producer blend price?

It is often asserted or implied that the Federal Order blend price is the same as the price paid to producers. In this hearing, this is the basis for the petitioner's assertion on page 4 of its petition that the blend price is -- quote, is the appropriate transfer price for analysis of the regulatory impact on the producer-handler plant, unquote. The blend price then becomes the justification for the hearing proposal to require producer-handlers to pay the difference between the Federal Order Class I price and the Federal Order blend price into the pool. While it is true that Federal Order administrators calculate a Federal Order blend price, this Federal Order blend price is not the price that is actually paid to most producers. Most producers are members of cooperatives who blend and even reblend their receipts across Federal Order markets to the point that the prices paid producers have little or not resemblance of the blend price calculated by the Market Administrator for a particular Federal Order market.
Let's talk real producer blend prices as they are received by producers and appear in Federal Order markets. The studies of mailbox prices paid producers indicate that there is wide variation in the prices paid to farmers, even among producers located in close proximity to one another. As explained by Professor Knoblauch, the longest running and best known of these Comparing Your Milk Checks studies has been conducted and published by Cornell University's Dairy Markets and Policy project since 2001. From these studies, I computed the differences in actual pay price -- price per hundredweight between the lowest 10 percent and the highest 10 percent of the participating New York producers for the months as indicated in Table 6 and Figure 4.

It is readily apparent that there is wide variation in the prices received by producers. For example, in September 2008, the highest 10 percent of the participating New York producers received a net price for their milk of $19.67 per hundredweight while the lowest 10 percent received $17.41 per hundredweight, a difference of $2.26 per hundredweight. Table 6
indicates from August 2001 to September 2008, this price difference ranged from $2.21 per hundredweight to $2.86 per hundredweight and averaged $2.57 per hundredweight. These data clearly indicate there is substantial variation in the price producers received for milk. More detailed analysis of these data indicates that while 65 percent of this variation can be explained by component values and the producer price differential, 35 percent is due to other factors with which the -- of which the largest 57 cents per hundredweight is a residual term referred to as the premium market value.

Also included in Table 6 is the Northeast Federal Order blend price as computed and reported by the Market Administrator. While the blend price falls between the price received by the lowest and highest 10 percent of the producers, the data clearly indicate wide variation in the net producer price around the blend price.

What is the implication of this finding for the outcome of this hearing? The NMPF asserts that, quote, as the market price for producer -- for producer milk on the market,
this (the uniform blend price) is the appropriate transfer price for analysis of the regulatory impact on the producer-handler plant, unquote. The IDFA likewise asserts, quote, the regulated price actually received by farmers is the uniform or blend price, unquote. If the uniform blend price is not actually received by farmers, how can it be the appropriate transfer price? Based on these false assertions, the NMPF and the IDFA conclude that producer-handlers should pay into the pool the difference between the uniform blend price and the Class I price. The NMPF's and IDFA's assertion is false because the uniform blend price clearly is not the market price and is not actually received by farmers. The fact is that there is a very wide range of market prices received by producers.

The only real and appropriate transfer price is the producer-handler's cost of producing milk, which, as we have seen from the testimony of Professor Knoblauch and verified by my AIDA member survey, is substantially higher than the uniform blend price calculated by the Federal Order Market Administrators.
Assertion versus Reality: Are producer-handlers a disorderly marketing force?

Deciding whether there is disorderly marketing requires an analysis of the economics of the marketplace for milk. In fact, defining what disorderly marketing is not, is as important and illuminating as what it is:

Disorderly marketing is not the same as marketing. Marketing is delivering the right product, in the right form, in the right place, at the right time, and at the right price. Just because producer-handlers are marketing milk products does not mean they are disorderly.

Disorderly marketing is not the same as niche marketing. Niche marketing is delivering the right product, in the right form, in the right place, at the right time, and at the right price where the product, form, or place is unconventional and limited in scope. Just because producer-handlers are niche marketing milk products does not mean that they are disorderly. This is the case because niche marketing firms, such as the AIDA members, generally sell their products at prices that are substantially higher than that of conventional
homogenous milk.

Disorderly marketing is not the same as private labeling. If it were, then many of the IDFA members would be engaged in disorderly marketing. The fact that a producer-handler private labels organic milk does not mean that it is engaged in disorderly marketing. Rather it is niche marketing within the private label category.

Disorderly marketing is not the same as being competitive. Being competitive involves being able to sell products you produce and yet be profitable. Being competitive without government intervention characterizes American capitalism, which we are now in serious danger of losing.

Now turning to what is disorderly marketing: At the time that the AMAA was enacted, the orderly marketing emphasis was, quote, to establish and maintain an orderly flow of products to markets...in the interest of consumers and producers...to avoid unreasonable fluctuations in supplies and prices, unquote.

In the 1930s producer marketing was highly disorganized and lacked orderliness. The
1962 Nourse Report to the Secretary of Agriculture, which in the past was often used for guidance in Federal Order decisions, described the situation as follows: Dairy farmers attributed their difficulties primarily to three factors: (a) they were dealing individually as small producers of a highly perishable product in a market generally dominated by a few large buying units; (b) their milk, even though it met minimum market standards, varied considerably in quality, and in quantity it was subject to wide seasonal variations; these condition -- (c) these conditions made them vulnerable to severe price cuts by dealers at flush seasons (or even partial or temporary losses of market outlet), and enabled dealers to reap most of the profit from supply shortages while the farmers had to bear most of the penalties of market surpluses, unquote.

While this -- excuse me. This is a very different situation than exists today where our cooperative -- where our milk markets are dominated by a few very large cooperatives, who, as we have seen, are able to extract premiums
from sometimes equally large processors, who effectively control the allocation of shelf space in supermarkets.

While the 1962 Nourse Report credited Federal Orders with having restored orderly marketing, it also recognized that, quote, complete and perfect orderliness in the disposal of fluid milk in all at that time 81 Federal Order markets has not been achieved. That would not be possible, or indeed desirable, in a dynamic enterprise market, unquote. The Report also recognized the changes that had occurred and were occurring in the milk industry. In a concluding section titled, quote, There Are Still Elements -- Are There Still Elements of Disorder, unquote, the Nourse Report states, quote, another element of disorder in price and production relationships results from the negotiation of premiums above established Class I prices in a number of markets. Such premiums introduce an element of instability both within the market area affected and in intermarket price relationships.

The 1972 Report of the Milk Pricing Advisory Committee, titled Milk Pricing Policy
and Procedures: Part I: The Milk Pricing Problem to USDA's Assistant Secretary of Agriculture in charge of the Federal Order program, picked up on the concern expressed by the Nourse Report that cooperative premiums and reblanding were not the only source of disorderly marketing conditions but also made it difficult for the Secretary to achieve the objectives of the Agriculture Marketing Agreement Act.

Let me read it again. The 1972 report of the Milk Pricing Advisory Committee, titled, Milk Pricing Policy and Procedures: Part I: The Milk Pricing Problem to USDA's Assistant Secretary of Agriculture in charge of Federal Order programs, picked up on the concern expressed by the Nourse Report that cooperative premiums and reblanding were not only a source of disorderly marketing conditions but also made it difficult for the Secretary to achieve the objectives of agricultural -- of the Agriculture Marketing Agreement Act. It concludes that, quote, Reblending of returns under a number of different orders can result in blend prices to producers that differ materially from blend
prices established under the orders involved. Thus the influence of the structure of prices resulting from the Secretary's decisions may be altered, making it more difficult to achieve the objectives of the Act, unquote.

The 1962 Nourse Report to the Secretary of Agriculture painstakingly defined the orderly marketing objective of Federal Orders to include economic terms such as equalizing the market power of buyers and sellers, assuring adequate and dependable milk supplies, maintaining economic order in the industry, ensuring equitable treatment of all parties and maximum freedom of trade with proper protection against the loss of outlets. The emphasis here on is on maintaining a regulatory balance among all parties in the marketplace and treating all parties equitably, and by implication not necessarily equally. Certainly the Nourse Report concept of orderliness would not support regulations that put minority independent producer-handler interests at a competitive disadvantage. The Milk Pricing Advisory Committee expands on this point by stating that, quote, orderliness implies protecting the rights
of producers to choose their market outlet, free of coercion and unreasonable barriers to market entry, unquote. Surely a producer-handler falls within the definition of a producer.

This review of the origins of disorderliness, the definition of orderly marketing as contained in the Agriculture Marketing Agreement Act of 1937, as amended, and of its adaption to the changing structure of the milk industry has particular relevance to the outcome of this hearing in the following ways:

Never once in either the Nourse or the Milk Pricing Advisory Committee Reports was there a mention of producer-handlers as a source of disorderly marketing. Available Dairy Division data would suggest that when the Nourse Report was written in 1962, there were about 370 producer-handlers, and in 1972 about 360. Today there are 37. In 1962 and in 1972, most of these producer-handlers were niche marketing firms delivering milk to homes and struggling to compete and to survive. Today, most producer-handlers are also niche marketing firms and struggling to compete in a much more complex markets and to survive. Yes, some of today's
producer-handlers are larger, but so are both cooperatives and conventional processors.

Is it just an issue of size? I suspect that for the NP -- NMPF and IDFA it is an issue of size, but it is also an issue of market control. This market control began to evolve at the time the Nourse and Milk Pricing Advisory Committee reports were being written. These are the same pressures that surround the producer-handler issue being discussed in this hearing.

But the size issue is substantially different than the NMPF and IDFA would like to have you believe. It can readily be determined from Table 1 that in 1969 there were 343 producers for every producer-handler; in 2008 there were 1,018 producers for every producer-handler. In 1996 there were 89 producers for every handler.

JUDGE CLIFTON: Start that one again, please.

DR. KNUTSON: In 1969 there were 89 producers for every handler.

MR. CARROLL: I have 69.

DR. KNUTSON: In 2008 there were 143
producers for every handler. In 1969 there were 3.9 handlers for every producer-handler; in 2008 there were 7.1 handlers for every producer-handler. The conclusion I draw from these data is that by every one of these measures, the position of producer-handlers is slipping. The effect of the regulations proposed by the NMPF and IDFA is to either deny the existence of producer-handlers or to put them out of existence. As a matter of national policy, it makes no sense to eliminate the opportunities for producers of all sizes to create independent viable dairy businesses.

It is impossible to reason that the existing producer-handler exemption, with only 1.46 percent of the fluid milk market and an impact of only about a penny would disrupt the flow of products to market, deny producers an adequate milk -- adequate supply of milk.

JUDGE CLIFTON: Let me stop you and have you start again, please, paragraph 47.

DR. KNUTSON: It is impossible to reason that the existing producer-handler exemption, with a 1.46 percent of the fluid milk market and an impact of only about a penny a hundredweight
would disrupt the flow of products to market, deny consumers an adequate supply of milk, or cause unreasonable fluctuations in the milk supply and prices.

Assertion versus reality: Do producer-handlers shift balancing costs?

First, it needs to be recognized that cooperative balancing is not just a service to the market. Balancing is an integral part of cooperatives' marketing strategy. That marketing strategy includes the fact that cooperatives get their market power from performing the balancing function. Therefore, balancing is a much bigger benefit to cooperatives than it is a cost to them. The benefit is that it gives them control of the milk supply, which allows them to negotiate full supply contracts. Without balancing, cooperatives would -- could not negotiate either full supply contracts or premiums.

Because cooperatives perform the balancing function, who are not cooperative members --

JUDGE CLIFTON: Let's start again.
DR. KNUTSON: Because cooperatives perform the balancing function, producers, who are not cooperative members, may not have an outlet for their milk. Because cooperatives perform the balancing function, large processors, who do not sign full supply contracts and submit to premium charges, may not have a regular supply -- milk supply as needed.

By similar reasoning, cooperatives desire to control the supply -- milk supply of producer-handlers. If they cannot do it overtly, they desire to do it through regulation, which would result if producer-handlers are eliminated. That is, producer-handlers are not cooperative members and will never be as long as they are producer-handlers. Through their proposal, however, the cooperative members of the NMPF greatly enhance their chances of gaining control of producer-handlers' milk supply by putting them out of the business of producing milk, processing milk, or both. This is what appears to be happening in the Pacific Northwest Federal Order.

The added advantages that cooperatives
gain from balancing involve realizing economies
from procurement, capturing economies from
producing manufacturing products and profiting
from marketing manufactured dairy products.

Conventional processors chose not to
balance -- choose not to balance -- excuse me,
let me start over.

Conventional processors choose not to
balance because cooperatives' control over the
milk supply means that they have no alternative
but to use the cooperative as a source of
supply. Those that attempt to maintain an
independent producer source of supply,
experience higher costs in maintaining an
independent producer source of supply and
consistent pressure from the cooperatives for
full supply contracts. Most conventional
processors have given in to that pressure.

One of the contentions in this hearing is
that producer-handlers get a free ride at the
expense of cooperatives who perform the
balancing function. Responding to this
contention requires a look at the facts on both
the demand and the supply sides.

On the demand side, producer-handlers are
effectively prohibited, by Federal Order regulations, from purchasing significant quantities of raw milk, if the regulations permit any purchases of raw milk at all.

On the supply side, no data has been produced by the Dairy Programs to indicate the quantities of milk, in excess of their own use, that is put on the market. Based on data that I obtained from six producer-handler AIDA members, in the high sales month, only 13 percent of production was sold on the raw milk market. Most of this milk was sold at the lowest use Class price and carried a large handling charge. Based on the Federal Order milk deliveries and producer-handler sales given in Table 1, the 13 percent of raw milk sales by producer-handlers would be 0.64 percent, (six-tenths of one percent) of the 2008 milk deliveries.

The factual conclusion is clear: Producer-handlers do not rely on the regulated market to balance their milk supplies. Production levels are managed to correspond to their product sales plus a sufficient surplus capacity to assure adequate milk for bottling.
Producer-handlers bear the burden of selling their small surplus on the market at the most advantageous price available, which is almost always at a loss.

Evaluation of the proposed regulatory options.

AIDA has offered four alternative proposals for consideration at this hearing. The USDA noticed two of these proposals related to the treatment of own-farm produced milk as a single alternative. But it is the intention of I -- of IADA that these alternatives be treated as distinct proposals.

JUDGE CLIFTON: Would you read those letters again?

DR. KNUTSON: AIDA.

JUDGE CLIFTON: Or?

DR. KNUTSON: Or?

JUDGE CLIFTON: A -- okay. Started with A.

DR. KNUTSON: AIDA.

JUDGE CLIFTON: Good. Thank you.

DR. KNUTSON: The first alternative AIDA proposal, Proposal Number 23, would exempt the own-farm produced milk of any handler from
inclusion in the handler's computation of milk value. This alternative would permit any handler who utilizes the milk from farms owned and controlled by the handler to exempt those volumes from regulation. The handler would still be treated as a fully regulated handler or partially regulated handler, pursuant to the terms of the applicable mark -- applicable Marketing Order. But when calculating the handler's producer settlement fund obligations, the handler would down-allocate the volumes of own-farm produced milk to the handler's lowest value use. This alternative would serve two purposes:

First, it serves as an alternative to the Draconian and unsupported proposals from the NMPF and IDFA to eliminate producer-handler status in all marketing areas. While Proposal 23 would eliminate the need to continue designating producer-handlers as such, it still requires that those handlers who utilize own-farm produced milk demonstrate to the satisfaction of the Market Administrator that the processing facilities and production facilities are under the same ownership and
control of the same entity. AIDA intends that the Market Administrator be vested with the authority to conduct such audits of the handler's facilities and record to ensure that there is commonality of ownership and control of those facilities used to produce milk claimed as exempt. It would remain the burden of the handler to demonstrate entitlement to this exemption, as is currently the case with -- with producer-handler designation.

Second, Proposal 3 -- second, Proposal 23 would permit the handler with own-farm production to purchase milk from the pool sources. But all such purchased milk would be up-allocated to the handler's highest value use, ensuring that pool producers receive the full benefit of all Class I markets served by the handler's purchase of milk from the pool producers.

What economic impacts would Proposal 23 have on the market for milk? Proposal 23 would allow producer-handlers to continue to exist and compete in an orderly manner. It would allow producers and cooperatives to benefit from producers' sales in excess of their producing.
This change in Federal Order regulatory policy would reduce incentives for surplus production.

Proposal 23 was also noticed with a second provision, which was submitted by AIDA following the USDA's prehearing information session. This provision, which permits a handler with own-farm production to elect partially-regulated distributing plant status for volumes of its own-farm produced milk, was intended as an alternative to full exemption of own-farm produced milk. This proposal, which AIDA intends to be treated as a distinct proposal, would allow those handlers with own-farm production to treat the volume of -- volumes of its own-farm produced milk in the same manner that USDA currently permits partially regulated handlers to treat their milk purchases. This proposal includes language intended to ensure that the handler with own-farm production markets its products at or above its costs, which would be the applicable Class I price plus the costs of manufacturing, processing, handling, marketing, and delivery. The handler with own-farm production would, as to the volumes of own-farm handled milk, place
such handlers on the same regulatory footing as partially regulated handlers, who currently distribute milk in any Federal Milk Marketing areas. As to volumes of milk acquired from sources other than the handler's own farm, those volumes would be treated according to the handler's regulatory status as a regulated or partially regulated plant.

What economic impacts would this second provision of Proposal 23 have on the market for milk? This provision of Proposal 23 would allow producer-handlers to elect to be a partially regulated plant for milk that it produces. By treating own-farm production in the same manner as USDA currently permits partially regulated plants to treat their milk purchases, this provision allows producer-handlers to continue to exist and compete in an orderly manner. It would allow producers and cooperatives to benefit from producer-handlers' sales in excess of their production. This change in Federal Order regulatory policy would also reduce incentives for surplus production.

Proposal 24 is intended for adoption only if USDA adopts -- adopts restrictions on the
volumes of producer-handlers. If USDA
eliminates the designation of producer-handlers,
it is intended that Proposal 24 be incorporated
into the Marketing Orders to have the same
effect as if incorporated into a
producer-handler definition that contains a
volume limitation. Under Proposal 24, a
producer-handler who disposes of its milk
products in retail outlets controlled by the
handler or sales direct to the consumer by the
handler, would be exempted on those volumes.
The rationale for this proposal is that under
any legitimate construct -- construct, such
sales are entirely controlled by the handler and
do not have an impact on the regulated market.
Handlers who control the milk supply chain from
production through processing and through its
final disposition, operate autonomously from
orders. AIDA intends this exemption to be
liberally construed. For example, if a
producer-handler utilizes independent
contractors to complete home delivery of its
products, but it is the handler who is
responsible for the maintenance of those home
delivery customers, then the exemption should
apply, even if title to the product may pass to the intermediate contractor before delivery to the consumer. In this setting, it is the handler who maintains the responsibility for the retail sales.

JUDGE CLIFTON: Doctor, I just want to clarify something that's right in the middle of that paragraph 63 --

DR. KNUTSON: Yeah.

JUDGE CLIFTON: -- on page 25. There is a sentence that begins: The rationale for this proposal.

DR. KNUTSON: Yeah.

JUDGE CLIFTON: Now, the last word of that sentence is pool and you read it as market.

DR. KNUTSON: Excuse me, no.

JUDGE CLIFTON: It may not make a lot of difference, but I want you to read it the way you want it.

DR. KNUTSON: Okay. The rationale for this proposal is that under any legitimate construct, such sales are entirely controlled by the handler and do not have an impact on the regulated pool.

JUDGE CLIFTON: Thank you. And now then
on to paragraph 64.

DR. KNUTSON: What economic impacts would Proposal 24 have on the market for milk? Proposal 24 would restrict producer-handlers to outlets that they control. In this sense, it is considerably more restrictive -- it is considerably more restrictive than the current policy. It would allow those producer-handlers that sell directly to consumers to continue to exist and to compete in an orderly manner.

Finally, AIDA Proposal 25 would establish individual handler pooling in all markets, as opposed to the current marketwide pools. I will subsequently explain why there are significant economic benefits to individual handler pools over marketwide pools. But here, I want to explain the intent behind the AIDA proposal.

The regulatory language in the Notice of Hearing would be effective in creating individual handler pools. The language was submitted to convey AIDA's intentions to do so within the framework of the current regulatory language. In addition to changes that have been noticed, there are conforming changes to the Marketing Orders that would be required to fully
implement individual producer-handler pools.

Perhaps the most significant --

JUDGE CLIFTON: Could you restate again the last part of that sentence? Maybe start again. In addition.

DR. KNUTSON: In addition to changes that have been noticed, there are conforming changes to Marketing Orders that would be required to fully implement individual handler pools. Perhaps the most significant would be the elimination of the provisions dealing with pool qualification. As I explain later in my testimony, one of the principal benefits of individual handler pools is that the producers entitled to share in the pooled price are immediately identified by delivering their milk to the plant. Other conforming changes may be required, including determination of whether a distinction between pool plants and partially regulated distributing plants need to be modified. Those specifics are best left to those who formulate Federal Order language. For example, USDA could revert to order language similar to that utilized in previous individual handler pools, such as -- here I strike Federal
for -- Upper Peninsula Marketing Order, the
Upper Peninsula Marketing Order.

JUDGE CLIFTON: And that's on page 26,
within paragraph 66. And that paragraph ends as
follows, comma --

DR. KNUTSON: Such as the Upper Midwest
Peninsula Marketing Order.

JUDGE CLIFTON: Okay.

DR. KNUTSON: Upper Peninsula Marketing
Order. I'm sorry.

JUDGE CLIFTON: All right. There is no
Midwest in there?

DR. KNUTSON: No Midwest, no.

JUDGE CLIFTON: Okay.

DR. KNUTSON: Under individual handler
pools, perhaps the single largest change would
be made -- would be that manufacturing plants
would not necessarily be subject to regulation.
Of course, that is the case today. But those
plants generally have an incentive to
participate in the pool, since under marketwide
pooling of returns, their purchases are
subsidized by drawing money from the producer
settlement fund. This permits producers
shipping their milk to manufacturing plants to
receive more for their milk than the
manufacturing plant actually pays for the milk.
In essence, pool distributing plants (and the
producers supplying them) subsidize the
production of Class III and Class IV products.
But when the -- when the USDA minimum prices for
Class III and Class IV milk rise rapidly, a
price inversion occurs. This occurs because the
USDA price formulas that establish the prices
for Class I milk lag manufacturing class prices
by two months. When a price inversion occurs,
manufacturing plants would pay into the producer
settlement fund rather than draw from it. So in
those instances, manufacturing plants elect not
to participate in the pool. This opportunistic
depooling has negative effects on the payments
to producers who are required to pool their
milk. These effects have been described in
several hearings held by USDA to address
depooling and need not be repeated here.
Information on the extent of depooling indicates
that efforts to address depooling have not been
entirely successful.

Benefits -- the benefits of individual
handler pools include:
First, manufacturing plants, unless they affiliate with distributing plant -- with a distributing plant will not pool their milk. That is no different than under the current marketwide pooling scenario, where manufacturing plants in many instances elect to pool only when it is economically advantageous to do so.

Second, the negative effects of opportunistic depooling, which continue to damage producers to the tune of millions and millions of dollars each year, will cease.

Third, and perhaps most important, milk in higher use Classes will move to locations where it is needed, thus eliminating the need for call provisions and regulated -- and related regulatory incentives.

Fourth, and closely related to the third benefit, all Class I revenues are channeled to those producers who are actually serving the Class I market.

Fifth, there is little incentive for the supply area to expand beyond that which is sufficient to serve the needs of the market, thus saving transportation costs.
market area is a critical function of any Marketing Order. The fact that milk is able and willing to depool suggests that such milk is not ready or necessary to serve the needs of the fluid market. As such, it should not necessarily be entitled to receive the benefits of the order. The Class I utilization of the entire Federal Milk Marketing Order system now stands at approximately 39 percent. This means that under current marketwide pools, more than two times the amount of milk needed to serve the fluid market is receiving the benefits of the fluid market. The intent of the Federal Milk Marketing Order system should not be -- should not be to allow all milk to be pooled, but to ensure that the consuming public has access to a sufficient supply of milk at reasonable prices. That goal can and would be accomplished by the individual handler pools.

The proponents of --

JUDGE CLIFTON: Excuse me. Before you go on to paragraph 70 -- we're on page 28 -- I just want you to highlight the word fluid that you have in the next to the last sentence, and that you didn't recite --
THE WITNESS: A sufficient supply of fluid milk at reasonable prices.

JUDGE CLIFTON: Thank you.

DR. KNUTSON: The proponents of marketwide pooling will likely assert that individual handler pooling is a move away from equal treatment of producers. However, I have clearly shown with data that producers do not now receive equal prices. Even under individual handler pooling, a cooperative will have the option of continuing to blend its returns among its members.

What economic impacts would Proposal 25 have on the market for milk? Proposal 25 would treat producer-handlers the same as any other handler, in that it would be its own regulated pool under the order. It would allow producer-handlers to buy milk from other producers at no less than its own blend price based on its utilization as calculated by the Market Administrator. In addition to the benefits discussed previously, it would allow all producer-handlers to continue to exist and compete in an orderly manner. It would allow producers and cooperatives to benefit from
producer-handlers' sales in excess of their production. It would reduce incentives for surplus production.

Impacts of an unfavorable producer-handler regulatory decision on small business. It is important to recognize that an unfavorable decision to producer-handlers from this hearing would have highly negative effects. These negative effects would not only be on producer-handlers as small business firms, but will extend to consumers who rely on producer-handlers for their milk supply and on the broader milk market. At the risk of repetition, let me summarize by describing the following sequence of negative events: First --

JUDGE CLIFTON: Let me interrupt you. You actually called that sequence likely. Is that correct?

DR. KNUTSON: The likely sequence of negative effects, okay?

JUDGE CLIFTON: Of negative events?

DR. KNUTSON: Negative events, okay. Sorry.

First, producer-handlers will be put out of business by producing milk -- out of the
business of producing milk, processing milk, or both.

Some portion of the bottling business will go to conventional -- will go to large conventional processors, and over time all of it will likely end up there.

Substantially all of the milk volume will be handled by the dominant cooperative.

Employment will decline, particularly in rural areas where most of these firms are located.

Milk consumption will continue to decline as the innovations fostered by smaller business firms are lost.

Concluding remarks.

In considering whether a national policy change eliminating the historic producer-handler status is justified, it is essential for the USDA to fully consider the characteristics of the U.S. milk market today. Class I milk is no longer the dominant milk usage in the national market. From Table 1 it can be determined that fluid milk utilization has shrunk from a national average of 64.3 percent in 1969 to a national average of 38.7 percent in 2008. Based
on FAPRI data, it could decline to 34.7 percent in 2017. In its narrative on the dairy outlook and situation, FAPRI notes that, quote, Fluid milk consumption is expected to continue to decline over the baseline, unquote. FAPRI then concludes that, quote, Changes in fluid milk consumption are having smaller effects on producer milk prices because a smaller percentage of the milk production is used for fluid purposes, unquote. The data equivalently indicates that cows' milk faces stiff competition from fluid milk substitutes, whether it be soymilk, goat milk, juices fortified with calcium, other juices, soft drinks, teas, coffee, or water in its proliferating number of forms. A regulatory system that fails to account for the fact -- that fact and continues to promote concentration on a shrinking fluid milk market share -- fluid market share serves no one, not producers, not cooperatives, not processors, not producer-handlers and not consumers.

It is time that the milk industry and the firms that represent it focus on the reality of today's milk markets. Milk is no longer a
homogenous commodity and should not be regulated as such. Producers are an important part of the milk industry.

JUDGE CLIFTON: Start that sentence again, please.

DR. KNUTSON: Producers are an important part of the milk industry.

JUDGE CLIFTON: I agree. Are you wanting there to focus on --

DR. KNUTSON: Producer-handlers. Excuse me, I'm sorry. Producer-handlers are an important part of the milk industry, not in terms of the volume and the share of the market, but in terms of the products, innovations, and customers they serve. They are not a threat to anyone and should not be treated as such. They are producers who have chosen to innovate and also be processors. They have expanded the market for milk and its products. The members of AIDA have proposed a set of viable options -- viable Federal Order options for allowing these firms to survive.

Finally, the AIDA proposals are designed to move national dairy policy in the direction of achieving the type of equitable competitive

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dairy industry balance between
producer-handlers, processors, and cooperatives
that was envisioned by the Nourse Report. In
fact, this proposal by NMPF and IDFA has nothing
to do with reducing disorderly marketing. For
NMPF, it is designed to prevent producers from
leaving cooperatives to operate processing
plants. Therefore, an otherwise hidden
objective of the NMPF proposal is to severely
limit the value-added options available to milk
producers. For IDFA it provides a means of
reducing the number of competitors and,
therefore, competition within the dairy
industry. Any of the options proposed by AIDA
makes more economic sense as national Federal
Order policy than the alternative presented by
NMPF and IDFA petitioners, because it retains
milk producers' options for the future and
allows producer-handlers to survive and continue
to build the market for milk.

JUDGE CLIFTON: I had one other question
about the way you read your statement,
Dr. Knutson. Would you turn to page 9?

DR. KNUTSON: Yes.

JUDGE CLIFTON: I mean page 8.
DR. KNUTSON: What's the item?

JUDGE CLIFTON: Do you see at the top of your bullet point, the first year you show there is October 1969?

DR. KNUTSON: Right.

JUDGE CLIFTON: For the first month. Then in the next paragraph, paragraph 18, you use the year 1960 without having given us data except '69.

DR. KNUTSON: Yeah.

JUDGE CLIFTON: Which makes me think you mean '69.

DR. KNUTSON: No, it's '60 and the data is given in the -- by the Dairy Programs in their basic table on numbers.

JUDGE CLIFTON: Okay. So -- so the number of producer-handlers is 421 --

DR. KNUTSON: Ah, I see what you're saying.

JUDGE CLIFTON: -- both in '60 and '69?

DR. KNUTSON: I would have to check on the exhibit that that's in.

JUDGE CLIFTON: Would you?

DR. KNUTSON: Yes.

JUDGE CLIFTON: And then you can report
back to us which way you want that page.

DR. KNUTSON: I will. Could be a typo.

JUDGE CLIFTON: Good. And I appreciate so much the care with which you've put together this statement.

How do you want, Mr. Miltner, to address what is left in this exhibit?

MR. MILTNER: I would suggest, your Honor, that we're going to have some brief direct examination. I know Dr. Knutson has been speaking for almost an hour again, and I'd like to try to coordinate those questions with Mr. Ricciardi so we're not duplicative and we can organize this. I would suggest ten minutes if we could.

JUDGE CLIFTON: That would be -- that is an excellent idea. Thank you. Let's see. It is 4:40. Please be back and ready to go at 4:50.

(A recess was taken from 4:40 to 4:51.)

JUDGE CLIFTON: We're back on record at 4:51. Dr. Knutson, there was one other question I had on page 30 and that is your reference to FAPRI, F-A-P-R-I. I don't know what that is.

DR. KNUTSON: FAPRI. I think it's
JUDGE CLIFTON: Okay.

DR. KNUTSON: I hope. It's --

JUDGE CLIFTON: It's page 30. I see a website and it has something to do with Iowa State.

DR. KNUTSON: Yeah. FAPRI is the Food and Agriculture Policy Research Institute.

JUDGE CLIFTON: Ah, good.

DR. KNUTSON: At Iowa State University and the University of Missouri.

JUDGE CLIFTON: Very good. Thank you so much. Mr. Miltner.

MR. MILTNER: Thank you, your Honor. I have some, what I hope to be relatively brief, questions here on direct. And we'll start with Dr. Knoblauch.

And I wanted to start initially with the chart that's attached to your statement because I don't think we had a chance to describe that. If you could give us an idea of the data on that and what that chart depicts.

DR. KNOBLAUCH: This is the last page to my testimony, Exhibit 90, and that last page shows the raw data as well as a graphic
representation of the costs of production, both from the Dairy Farm Business Summary and from the Economic Research Service in comparison to the Federal Milk Marketing Order Number 1 uniform price, Southwest Class I price in that same order.

MR. MILTNER: And the data, the source data on that chart is -- is from your -- your Cornell data and USDA-ERS and USDA sources, is that right?

DR. KNOBLAUCH: That's correct.

MR. MILTNER: Your Honor, could you provide Exhibit 23 for us, please?

JUDGE CLIFTON: Certainly. And Exhibit 23 is the statement from the National Milk Producers Federation, Dr. Cryan.

Dr. Knoblauch, if you could turn to page 11 of that and take a look at it? First of all, have you had a chance to see that testimony before?

DR. KNOBLAUCH: I have seen his testimony. I don't know if it was in exactly this form or not but --

MR. MILTNER: Okay. If you could turn to -- if you saw his testimony, then that's --
that's what you had seen.

DR. KNOBLAUCH: Okay.

MR. MILTNER: I want you to look at page 11 and there's a -- there's a graph on that page. Do you see the graph there?

DR. KNOBLAUCH: Yes, I do.

MR. MILTNER: Have you had a chance to see that graph in that form before?

DR. KNOBLAUCH: Yes, as presented in Exhibit 23.

MR. MILTNER: Okay. Have you had the chance to, before now, read the statement that accompanies that chart in the statement?

DR. KNOBLAUCH: Yes, I have.

MR. MILTNER: Okay. Do you think that the chart, as depicted there, accurately reflects the -- the achieved economies of dairy farms based on your research and the other data that you have reviewed?

DR. KNOBLAUCH: Well, I think the first point to be made is that while the data points represented in this graph do come directly from an ERS USDA publication, placing them on a graph such as this and then providing the interpretation that he has done is, at best,
Mr. Miltner: How would you interpret the same data? You say the interpretation that's provided and the graph is misleading. First of all, what do you find misleading about the way it's been presented here?

Dr. Knoblauch: Well, basically the largest herd size category is greater than a thousand cows, the average of which is something over 2,000 cows. So that's a very, very large interval from a thousand to more than 2,500 or about 2,500 is my memory. And to just find a midpoint and say that it goes down directly, that slope between the average of herds between 500 and a thousand cows and herds over a thousand just is not true.

Mr. Miltner: If you look at the last point on that chart, is that point approximately where that average herd size is in that large -- that large category, based on your knowledge of the ERS study?

Dr. Knoblauch: Yes. This is going from memory, but I believe the average of that larger herd size category was something like 2,083 cows.
MR. MILTNER: Okay. Is there a more accurate way to depict what that curve would look like in your opinion?

DR. KNOBLAUCH: Yes. In the same publication there's another graph a few pages later which describes both the average as well as an economic frontier that was computed. And that would be the appropriate data to rely upon especially as it relates to determining what that cost curve -- or I should say the shape of that cost curve is out at the larger herd sizes.

MR. MILTNER: And then that study that the data is taken from is the ERS report Number 47 titled, Profits, Costs and the Changing Structure of Dairy Farming?

DR. KNOBLAUCH: That's correct.

MR. MILTNER: And cited as a reference in your testimony as well?

DR. KNOBLAUCH: Yes, it is.

MR. MILTNER: And that's the ERS data that you have relied upon and some of the opinions you've put forth in your statement?

DR. KNOBLAUCH: That's correct.

MR. MILTNER: Okay. So same data, different interpretations?
DR. KNOBLAUCH: Actually, same report. This data that Dr. Cryan relies upon is in that report, but then the report goes on and does further analysis and explains an analysis to take this data a step farther.

MR. MILTNER: And is it that frontier you described that's contained in the ERS publication? Is that what you rely upon for your statement that scale economies virtually disappear after 1,250 cow herd size is attained?

DR. KNOBLAUCH: That is correct.

MR. MILTNER: And that statement is quoted. I quoted it from page 2 here of your statement, is that right?

DR. KNOBLAUCH: That's correct.

MR. MILTNER: You've had a chance to review and study the Cornell fluid milk processing plant study. And you referred to that in your statement, is that right?

DR. KNOBLAUCH: That's correct.

MR. MILTNER: And you've had a chance, I assume, not only to review the study but discuss that -- that research with its authors, who are also at Cornell?

DR. KNOBLAUCH: Yes, I discussed that
with Dr. Stephenson.

MR. MILTNER: Okay. Does that report suggest or document that a plant anywhere near 450,000 pounds of processing volume a month can compete at all with a modern, even modestly sized fluid milk processing plant?

DR. KNOBLAUCH: No. That report clearly shows that even at 30 million pounds and 40 million pounds and up that there are still economies of scale being realized.

MR. MILTNER: Okay. So would you come to the same conclusion for a 3 million pound per month processing plant, that it does not compete on the same economies of scale as those large plants?

DR. KNOBLAUCH: Not on economic only criteria, that's correct.

MR. MILTNER: If you could pass the microphone over to Dr. Knutson.

Dr. Knutson, let's start the same way that we did with Dr. Knoblauch's questions, and look at the -- the charts and data that you attached to your statement. Now, you -- I think you referred to all of them a little bit, but if you could just walk us through them one by one
beginning with Figure 1 and give us an idea of what's being depicted on these attachments.

DR. KNUTSON: Figure 1 is the number of producer-handlers operating in Federal Orders as reported by Dairy Programs in the indicated publication.

MR. MILTNER: Okay.

DR. KNUTSON: It's in the record, I'm sure.

MR. MILTNER: It is. And I believe it's Exhibit 7. I don't know if -- your Honor, if we want to formally identify that or not. The title of the document is exactly the same.

JUDGE CLIFTON: I think what you just did takes care of it.

MR. MILTNER: Okay.

MR. BESHORE: Exhibit number?

DR. KNUTSON: I'd like to turn next to --

MR. MILTNER: One second. There's not a question.

DR. KNUTSON: I'm sorry.

JUDGE CLIFTON: What is the question?

MR. BESHORE: What exhibit? I'm sorry. I didn't hear what exhibit was referred to.

MR. MILTNER: Exhibit 7.
MR. BESHORE: Thank you, Mr. Miltner.

JUDGE CLIFTON: And that is the same picture as which graph?

DR. KNUTSON: Figure 1.

JUDGE CLIFTON: Figure 1, okay. Figure 1 attached to Exhibit 89 is the same as Exhibit 7. Thank you.

MR. MILTNER: It's not the same, but it's the data that was sourced -- was sourced from what is Exhibit 7.

JUDGE CLIFTON: Thank you.

DR. KNUTSON: Okay. I'd like to turn to Table 1 next, because the other figures relate to Table 1 and the data in Table 1. So it's better to cover that first. This is all --

JUDGE CLIFTON: Let us catch up with you. Table 1 is a few more pages into the attachments?

DR. KNUTSON: Yeah, after the figures.

JUDGE CLIFTON: Okay. I have mine. Is everybody with Dr. Knutson?

THE WITNESS: It's titled, Comparison of Annual Average Size and Growth of Producers, Handlers and Producer-Handlers, Selected Years. All of the data in that table are from posted
documents, I believe, as indicated there. The exception, as I indicated in my testimony, relates to the producer-handler volume for 1969, 1980, and 1992.

And the Dairy Programs gives the percent of producer-handler sales in that same Exhibit 7 referred to previously. And I simply multiplied that by the Class I utilization or sales volume for the indicated years. And so the producer-handler sales volume is an estimated sales volume based upon the percent of Class I sales for those years which is in the Federal Order data that's been a part of this hearing. So that's -- that's where that comes from. Otherwise, they're all numbers that relate to posted material.

MR. MILTNER: So it's -- other than as noted, it's USDA data, much of which was posted to the USDA website for this hearing?

DR. KNUTSON: Exactly.

MR. MILTNER: -- and you're -- maybe we'd be quicker if we do this before. The fourth -- fourth source table titled, Packaged Disposition of Class I Milk Products by Handlers Regulated under Federal Milk Orders, by Product, 2000 to
2008 appears to be Exhibit 9, same title. And if we want to have Dr. Knutson identify it, that's fine. But he's identified the source as USDA website and the title of the document is identical.

MR. YALE: And that's for this Table 1?

MR. MILTNER: Yes.

JUDGE CLIFTON: On Table 1 look at the sources and go down to the fourth source. You see there are a number of sources for this Table 1. And the fourth source is Exhibit 9.

MR. MILTNER: The next source is titled Sales of Fluid Milk Products in Federal Milk Order Marketing Areas, by Producer-Handler, by order, 2000 through 2008. It appears to be exactly the same as the title on Exhibit 12.

JUDGE CLIFTON: Which numbered source is this on Table 1?

MR. MILTNER: The fifth source.

JUDGE CLIFTON: Okay. And that is Exhibit --

MR. MILTNER: 12.

JUDGE CLIFTON: -- 12.

MR. MILTNER: And the next source appears to be Exhibit 13, Producer-Handler Regulatory
Status 2005 to 2009.

JUDGE CLIFTON: Thank you, Mr. Miltner. That's very helpful. Is everybody with him?

MR. TOSI: No, your Honor. Can we run through that again?

MR. MILTNER: Now, the first one, Dr. Knutson, is Dairy Market Notes, the first source on there?

DR. KNUTSON: Actually, that's Federal Market Order statistics. Your Table 2, measures of growth.

JUDGE CLIFTON: We're still on Table 1.

MR. MILTNER: I'm sorry, we're looking at Table 1.

DR. KNUTSON: I know, yeah. It's data on producers, handlers, deliveries, and utilization 1962 to '92. And that was obtained from Dairy Programs table 2, Measures of Growth in Federal Milk Market Order Markets, years 1947 to 2006 and then -- and then also from the Dairy Market News for the last two years. The first one only went through 2006. And the last two years picks up 2007 and 2008.

JUDGE CLIFTON: Good. That's helpful. So everyone is with him so far on the first
source on Table 1?

MR. MILTNER: And the second source is Exhibit 7, is that right, Dr. Knutson?

DR. KNUTSON: Yes.

MR. MILTNER: The third one is data you had calculated as described in your testimony, right?

DR. KNUTSON: Right, right.

MR. MILTNER: Okay. The next source is, I believe we said, Exhibit 9. And then Exhibit 12 for the next source, and Exhibit 13.

MR. TOSI: Thank you.

DR. KNUTSON: Figure 2.

MR. MILTNER: Okay.

DR. KNUTSON: Figure 2 is simply the sales by producer-handlers, which is one of the columns. It's the average.

MR. MILTNER: And the source for that is the data we just described in Table 1?

DR. KNUTSON: Yeah -- no, it's the producer-handler sales volume. I'm sorry. It's not the average, okay?

MR. MILTNER: Okay.

MR. TOSI: The source for that?

DR. KNUTSON: Table 1.
MR. MILTNER: Yes.

DR. KNUTSON: And the same is true of the next one. It's the percent sales by producer-handlers in Federal Order markets. It -- it is in Table 1 but it's also in the Exhibit 7.

MR. MILTNER: Okay.

DR. KNUTSON: And Figure 4 is the difference in net pay to producer-handlers in New York -- ah, that's related -- let's look at one of the other figures. Let's look at the other tables and then we'll get to Figure 4.

MR. MILTNER: Okay. Which table would you like us to turn to?

DR. KNUTSON: 2. Table 2, the source of that is -- is the Federal Order small plant structure information and that's posted information. It was also appended to the IDFA -- excuse me, National Milk Producers Federation.

MR. MILTNER: And that's for May 2008?

DR. KNUTSON: For May. It is for May 2008, yeah.

MR. MILTNER: And that is Exhibit 18?

DR. KNUTSON: Yeah. Okay.
DR. KNUTSON: Then Table 3 is the Class I Cooperative Premiums. In fact, Table 3, 4 and 5 are all Class I cooperative premiums and they are all from -- they can all be found in Dairy Market News.

MR. MILTNER: Okay.

DR. KNUTSON: But the annual summaries are contained in Dairy Market statistics for the years indicated. So I'm not sure that these are -- whether these are in exhibit form here or not, but they're all USDA publications.

MR. MILTNER: I don't believe those are in exhibit form. But as you indicate, both Dairy Market News and Dairy Market statistics Annual Summary are USDA published compilations of statistical material.

DR. KNUTSON: Yes. The markets covered in Table 4 and 5 for premiums are -- I picked them. I didn't pick them for any particular reason except to get geographic distribution on them. And I wanted to include Chicago because of the importance of Chicago as an indicator of what the release charges or the give-up charges might be in that -- in the Minnesota-Wisconsin area, because most economists, as I indicated in
my testimony, feel that since USDA doesn't report give-up charges, that it's the best indicator of the movement in those -- in those give-up charges, if it doesn't actually reflect the actual level of those give-up charges.

    MR. MILTNER: Okay.

    DR. KNUTSON: And Table 4 is for April and Table 5 is for October. And the reason for April and October is, April is generally one of the peak flush months. It's after pastures get green and the calves are born and so forth. And October is usually one of the shortest months. So it provides a combination of the flush season and the short supply season of the year.

    And Table 6 is from the work of Mark Stephenson that Knoblauch referred to, and I -- I simply obtained that from Stephenson's publications, as indicated. And then Figure 4 simply plots that data over the time period so you can visualize how much difference there is between the two.

    In Table 6, the blend prices were obtained from the Northeast Marketing Order Administrator's report.

    MR. MILTNER: Okay. Thank you. I may
have a few more questions about specific points of your testimony here.

Dr. Knutson, are you familiar with the term, compensatory payment, in Federal Milk Marketing Order language?

DR. KNUTSON: Yeah. It's a payment into the pool by a plant.

MR. MILTNER: And you may need to pull the mic a little closer.

DR. KNUTSON: Excuse me. It's a payment into the pool by a plant.

MR. MILTNER: Okay.

DR. KNUTSON: The proposal by National Milk and IDFA would require a compensatory payment of producer-handlers of the difference between the uniform price and the Class I price.

MR. MILTNER: Or the plants' blend price based on their utilization, right?

DR. KNUTSON: Yes.

MR. MILTNER: Okay. So that's a compensatory payment. And the base for the compensatory payment is that of the blend price?

DR. KNUTSON: Yes, the Federal Order blend price.

MR. MILTNER: Federal Order blend price.
Now, are you familiar also with the term transfer price? I think you reference it in your statement.

DR. KNUTSON: Yes.

MR. MILTNER: Transfer price, compensatory payment base, how are those concepts linked, if at all?

DR. KNUTSON: They're directly linked to one another because the proposal links the transfer price to the -- the blend price, the uniform blend price. So the -- the proposal is directly linked to compensatory payment.

In other words, the difference in the payment between the uniform price and the Class I price is the compensatory payment.

MR. MILTNER: And from a -- from an economic perspective, does it -- does it make sense to -- to assign the transfer price at the same point as the base price for the compensatory payment? In other words, you criticized the transfer price is set at the blend, and why is that?

DR. KNUTSON: Because that's -- that's what they propose. That's their proposal.

MR. MILTNER: And from your perspective,
as an economist, the rational point to set that is not at the blend price but at their production?

DR. KNUTSON: Is at the cost of production of the producer-handler. I mean, the rationale is that you base the transfer price on the market price. You don't base a transfer price on a regulated Federal Order price that doesn't exist in the market.

So, you know, the best basis that you've got for what that transfer price is by a producer-handler is the producer-handler's cost of production.

MR. MILTNER: You've been studying Federal Order policy for a while, and the statement -- the statement is made by several people in this hearing that producer-handlers of the size we're seeing today were never contemplated at the time the Marketing Orders were adopted. Were the marketing orders intended or contemplating farms at all in sizes that we see today?

DR. KNUTSON: No. And, of course, they didn't contemplate --

JUDGE CLIFTON: Closer to the mic,
please.

DR. KNUTSON: No, it did not contemplate farms of the size we have today, nor did it contemplate processors of the size we have today.

MR. MILTNER: And how -- in your experience have the terms of the Marketing Orders generally been neutral as to the size of a farm?

DR. KNUTSON: I guess I don't understand the question. Are you saying, do Marketing Orders discriminate based upon the size of the farm?

MR. MILTNER: Yes.

DR. KNUTSON: Let me answer the question in this way. In terms of the fact that producers get paid based on volume, whether under a Marketing Order or not, favors larger farms. And -- and -- and so any regulation that results in higher returns to a particular -- to producers in general benefit large producers more than small producers.

MR. MILTNER: Just a couple more questions about some points in your statement. If you could look at paragraph 36 on page 16,
please.

DR. KNUTSON: Okay.

MR. MILTNER: You talk about in your 
second bullet point, a niche farm, such as the 
AIDA members, generally sell their products at 
prices that are substantially higher than that 
of conventional homogenous milk.

DR. KNUTSON: Yes.

MR. MILTNER: Some of the members in your 
area, as you found, don't do that?

DR. KNUTSON: Correct. That's covered 
in -- I was going to say it's covered in the 
last point, but it's covered in another point.

MR. MILTNER: It is covered?

DR. KNUTSON: Yes.

MR. MILTNER: And I want to make sure 
that that's clear on the record, that a niche 
market, in a sense, can be supplying competition 
to a market that's otherwise dominated or 
monopolized, is that -- is that right?

DR. KNUTSON: Well, you know, I'm not 
sure that I would put it in that context. I 
would say there are niche markets that serve 
particular segments of consumers and then there 
are markets that are contestable markets;
economists refer to them as contestable markets, where the margins are sufficiently high. The prices charged are sufficiently high that they invite competition. And that's the other circumstance. I wouldn't refer to that necessarily as a niche market. It's a contestable market concept.

MR. MILTNER: Thank you for that more accurate description of a contestable market.

I want to look quickly at paragraph 67 on page 26.

DR. KNUTSON: Yes.

MR. MILTNER: It begins on the last line on that page. I want to make sure we've described something correctly -- or you've described something correctly. It says, but when the USDA minimum prices for Class III and IV milk rise rapidly, a price inversion occurs?

DR. KNUTSON: Yes.

MR. MILTNER: I think it's just a misstatement of the order in which prices rise. Normally, the Class I prices rise rapidly and that is what creates the inversion. Am I -- is my recollection correct?

DR. KNUTSON: No. The manufacturing
price is the one that rises above.

    MR. MILTNER: Okay. My apologies.

    DR. KNUTSON: That's why they depool.

It's interesting -- if I could --

    MR. MILTNER: Please.

    DR. KNUTSON: The Milk Pricing Advisory Committee -- I don't think the Nourse Report, but the Milk Pricing Advisory Committee discussed this issue in some detail. And I might say the Milk Pricing Advisory Commission -- Committee was composed almost entirely of USDA experts, warned against forward pricing because of the potential of undermining the orders. And yet we have forward pricing.

    MR. MILTNER: I appreciate that observation. I do appreciate the observation. Your Honor, we don't have any more direct examination. Thank you.

    JUDGE CLIFTON: And, Dr. Knutson, I understand that you have authorized a change on page 8, paragraph 18, the second line. The 1960 there is actually '69, is that correct?

    DR. KNUTSON: Yes.

    JUDGE CLIFTON: Good. Thank you.

So Mr. Miltner, what do you move into
evidence?

MR. MILTNER: I would like to move in Exhibit 89 and 90. I think 91 was admitted previously.

JUDGE CLIFTON: It was indeed. Is there any objection to the admission into evidence of Exhibit 89 or 90? Mr. English?

MR. ENGLISH: I do not object to Exhibit 90. I'd like, as part of my cross-examination, which I think I will start tomorrow morning, to be able to voir dire on Exhibit 89 before I decide whether I'm going -- what I'm going to do.

JUDGE CLIFTON: All right. Does anyone have any objection to Exhibit 90, which is Dr. Knoblauch's statement? Is there any objection at all on that being admitted? There is none. I hereby admit into evidence Exhibit 90.

JUDGE CLIFTON: With regard to Exhibit 89, I will allow Mr. English the opportunity to voir dire, and then we'll see where we go from there on that statement. All right. Let me see what time it is, so I can see if we want to begin Dr. Yonkers tonight. We could get some
cross of Dr. Yonkers in, though if I'm going to let you go at 6:00, that's only half an hour.

MR. ENGLISH: Your Honor, I think if nothing else than to be consistent with my statements earlier today, since we don't know how long the cross would go, I think we should at least get started on that, that cross-examination.

JUDGE CLIFTON: I think that's a good idea. If by some miracle we finish tonight, that would be wonderful, and then Drs. Knoblauch and Knutson would know that they were first up at 8:00. So gentlemen, thank you very much. You may step down for now. Let's take -- can we really limit it to five minutes just to stretch?

MR. ENGLISH: Yes. Yes, your Honor.

JUDGE CLIFTON: Thank you. Please be ready to go at 5:35.

(A recess was taken from 5:30 to 5:36.)

JUDGE CLIFTON: We're back on record at 5:36. Dr. Yonkers was our cleanup batter on 12 May. That was only two days ago. And he's our cleanup batter today as well. Who would like to begin the cross-examination of Dr. Yonkers?
MR. VETNE: Your Honor, John Vetne. I don't have any cross-examination for Dr. Yonkers. I probably won't because his testimony more or less adopts NMPF's and so unless there's a wrinkle added by co-proponents in more quasi direct, I don't think I will have any.

JUDGE CLIFTON: Thank you, Mr. Vetne. Who else would like to cross-examine Dr. Yonkers?

JUDGE CLIFTON: Mr. Tosi, do you have any questions for Dr. Yonkers?

MR. YALE: No, your Honor. Right now we have no questions.

JUDGE CLIFTON: Is there any objection to the admission into evidence of Exhibit 80? There is none. Exhibit 80 is hereby admitted.

JUDGE CLIFTON: Is there anything further before we adjourn for the day? Mr. Yale?

THE WITNESS: He just can't do it.

MR. YALE: This has nothing to do with Dr. Yonkers. He is a very light witness. That's an inside joke.

You know, maybe we can argue about how to do the cross for Knutson and Knoblauch tonight,
and then that would take care of it because we spent more time about how we were doing his cross than doing his cross, but I have nothing.

MR. ENGLISH: I said it first.

JUDGE CLIFTON: You know, I hate to let him off this light. He -- he has had the easiest time of any witness who came here. That does not seem right.

MR. RICCIARDI: Why don't you ask him some questions?

THE WITNESS: Thanks, Al.

MR. HOLLON: Let's hear those magic words.

JUDGE CLIFTON: You know, I had some areas noted, but it doesn't seem to matter now. All right. I'll see you all at 8:00 in the morning. Thank you very much. We go off record at 5:45.

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PROCEEDINGS ADJOURNED AT 5:45 p.m.

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CERTIFICATE

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