correct, that's how we looked at it.

MR. RICCIARDI: Okay. Nothing further. Thanks.

THE COURT: Mr. Yale, do you have any questions?

MR. YALE: No.

THE COURT: Ms. Deskins, do you or your colleagues have any questions?

MS. DESKINS: No.

THE COURT: Any redirect?

MR. BERDE: No.

THE COURT: You may step down.

(Witness excused.)

THE COURT: Mr. Beshore, you were going to call the next witness; is that correct?

MR. BESHORE: Yes. Mr. Herbein, Carl Herbein.

THE COURT: Okay, Mr. Herbein, you were sworn in some months ago in this case, so that oath is good for your testimony now. I would like you to, for the benefit of the Reporter, please state and then spell your name for the record.

THE WITNESS: Carl D. Herbein, H-e-r-b-e-i-n.

THE COURT: Go ahead, Mr. Beshore.

CARL D. HERBEIN, PROPONENT'S WITNESS, PREV. SWORN

DIRECT EXAMINATION

BY MR. BESHORE:

Q. Mr. Herbein, this is your second time to the witness stand in this proceeding; correct?

A. That's correct.

Q. And you testified previously at Phoenix; correct?

A. Yes.

Q. Okay. Now, in connection with your testimony today, were you asked to evaluate -- on the basis of information which has been presented for the record and on the basis of the best information that you could assemble and have available, were you asked to evaluate on a pro forma basis the possible operation as regulated handlers of entities which are presently producer-handlers in Order 124?

A. Yes, that was my engagement.

MR. BESHORE: Your Honor, could I have the exhibit that I've distributed, 2-page exhibit, marked as the next --

THE COURT: It would be Exhibit Number 68.

(Exhibit No. 68 was marked.)

BY MR. BESHORE:

Q. And have you prepared, Mr. Herbein, a 2-page document that has been marked as Exhibit 68, in response to the engagement that you have just indicated?

A. Yes, I have.

Q. And the first page is titled "Regulated Handler, Federal Order 124, Pro Forma Income Statement - 12-Month

Period Ended December 31, 2003"; is that correct?

A. Yes.

Q. And the second page, then, of Exhibit 68 is captioned "Regulated Handler, Federal Order 124, Statement of Assumptions - 12-Month Period Ended December 31, 2003"; correct?

A. That's correct.

Q. Let's look, then, at Exhibit 68, and first of all, what is a pro forma income statement?

A. A pro forma income statement is a financial presentation that is based upon assumptions as opposed to something that is extracted from an entity's books. This is not actual activity but a presentation on a pro forma basis of a set of facts and circumstances put into proper form to show an income statement.

Q. Okay. And in this case, the information that may be available in any of the entity's books has not been made available for the hearing record; correct?

A. That's correct.

Q. Now, in doing the pro forma income statement, first of all, what -- you've got three columns on Page 1 of Exhibit 68, and the footnotes 1, 2, and 3 have some information with respect to those columns. Could you describe to us what the three separate columns represent.

A. Yes. First of all, the characterization here began with a size determination, and based upon USDA's average of the Order 124 larger producer-handlers, the overall average was 4.7 million pounds of Class I milk per month.

Q. Okay. So that 4.7-million-pounds-per-month figure is not an assumed figure but an actual figure from the hearing record information provided in one of Mr. Mykrantz's exhibits; correct?

A. Yes, that's correct.

Q. Okay.

A. And that's the middle column.

Q. Okay. And go, then, I interrupted you.

A. As I was saying, the middle column is the 4.7 million pounds of Class I. So as to test the pro forma and the market, the column 1 is 75 percent of column 2, or a 25 percent reduction in pounds, to 3,525,000 pounds of Class I per month. In column 3, as is indicated in Footnote 3, is 25 percent more than the average, to 5,875,000 pounds.

And I chose those three sizes so that the -- so that this proceeding could have statistical analysis of both the average and something below and something above the average.

Q. Okay. If we could look, then, at -- kind of on a line-by-line basis, your pro forma information, and let's just use the numbers in the first column, for the smaller entity. The revenue has two components: Class I sales and Class III/IV sales; correct?

A. That's correct.

Q. Okay. And could you explain, just using the smaller pro forma entity, the numbers there, how the revenue numbers were derived.

A. Yes, I'll be glad to. First of all, as to the split between Class I sales and Class III/Class IV sales, that ratio is 85.5 percent Class I sales and 14.5 percent Class III or Class IV sales, and that information, again, I extracted from this proceeding, and that is explained in Footnote 2 on the second page.

So that was the first step, in taking the pounds and dividing the pounds into how they were utilized. The second was: to apply a value to those pounds, and for that purpose, I converted the pounds into gallons of milk and then utilized USDA's published retail prices for 2 percent milk, average of three outlets, selected cities, by month, in 2003, for the first 7 months of 2003, for Seattle, Washington, and Portland, Oregon, and I used that basis for the value of the -- of the milk at the first step.

And then the second step, since that survey done by USDA is an out-of-store price survey, the next step was to get that into an into-store price, which is what these handlers would be selling, they're selling into store, not out of store, and the reduction from out of store to in store that was applied was a 40 percent reduction.

So that process was utilized, applied to the gallons, and that was how the $9.9 million was calculated.

The Class III and Class IV value was arrived at by taking the lower of Class III or Class IV and an assumption, again, described on Page 2, is that those sales were done at the market price, USDA's lower of III or IV, and that's how the $704,000 revenue number was calculated, and also the $704,000 cost.

Q. Okay. Let's -- just a couple other questions about those numbers. Why did you use the first 7 months of 2003?

A. To be consistent, I quoted -- extremely important that we not confuse the record with a lot of statistics from different time periods, and the 7 months -- the first 7 months of 2003 were used when this hearing began and when I testified the last time, so I felt that that was an appropriate category -- an appropriate time period to use.

Q. So some of your earlier -- your earlier exhibits presented in this hearing were based on price and other data for that same time period.

A. That's correct.

Q. Okay. Now, how did -- did you then project the volumes over a 12-month period, to show a pro forma annual -

-

A. Yes. I assumed that, for example, with column 1, the 3,525,000 pounds, that was the statistical number that I used, times 12, to get to a 12-month number, I wanted to show a full year of activity, that's what CPAs like to do when they report on financial activities, use a full year, so that you have a 12-month period, and in applying the -- both revenue and cost factors on a per-gallon basis from an average developed over a 7-month period, to 12 months, is an acceptable thing to do because the -- the issue there is the margin on a per-gallon basis, so if the prices in the last five months of the year are higher or lower, it's irrelevant when you're doing a pro forma presentation like this, because it's the margin that determines the bottom line.

Q. Okay. Now, let's talk about the 40 percent discount just a bit. I gather, if I understand you correctly, to get to the top line of Class I sales you took the price of USDA-published retail price series for out-of-store prices and reduced that by 40 percent to --

A. That's correct.

Q. -- to arrive at an into-store wholesale fluid milk product price; correct?

A. Yes, that's precisely what I did.

Q. Okay. How did you come to use the 40 percent discount figure?

A. There were a few factors, and in pro forma and analyzing assumptions, one must use all of the data that's available, and one piece of data that was available from this proceeding was the testimony of a Mr. Ellis, who talked about his margin in his business, and his margin was in the 30- to 40-percent range, buying milk from Smith Dairy and reselling it, and he explained his margin.

I also reviewed our firm's information on sales to stores and store margin-type information in markets such as Seattle and Portland, where there are some unusual characteristics with respect to other parts of the country, store specials and special distributor discounts. Many markets are different, and Order 124 has a good dose of difference.

So all of that considered led me to the 40 percent being the right reduction, so that the store owner would have an adequate margin to operate in this -- in this market and the distributor would have a margin and that we would have considered the specials, and then that gives you, after subtracting that 40 percent, an into-store price, which is what the revenue base for a processor is.

Q. Did you check the validity of that estimated into-store price with regulated handlers that you had access to in Order 124?

A. Yes, I did.

Q. And did they confirm that it was a reasonable number to use for a pro forma?

A. Yes. And we had -- we had detailed conversation about that, on pro forma, and this pro forma -- there certainly are transactions in this marketplace that would require more than 40 percent and less than 40 percent, so this is an average to be used, and that is also the concept of USDA's survey, is that it's an average of more than one -- one customer, or one type of customer.

Q. Okay. Now, just to get back to Mr. Ellis's testimony for a moment: is it your understanding that Mr. Ellis is a customer, a distributor, who acquires his product -- by his testimony in this hearing -- from Smith Brothers, one of the producer-handlers in Order 124?

A. Yes. And I heard Mr. Ellis's testimony personally.

Q. Okay. And he testified that he sells it for prices that are in the range of the prices on the supermarket shelves, in fact between the lower -- the store brand and the non-store brand price; correct?

A. Yes, that was my understanding of his testimony.

Q. Okay. And he arrived at those sales prices to his customers by purchasing the product at Smith Brothers and marking it up 30 to 40 percent, by his testimony. Correct?

A. Yes, that is, that was his testimony.
Q. Okay. Now, your total revenue line, then, represents the simple aggregate of the revenue from Class I sales and Class III and IV sales, as you've calculated them; is that correct?
A. Yes. It's a simple addition.
Q. Could you then review how you -- for your pro forma, the operating expense entries that you calculated.
A. Yes. The first, and the largest, operating expense that these pro forma regulated handlers have is the cost of raw milk for the Class I portion of their business, and that has been reflected at the Class I price that USDA announced, again, for the first 7 months of 2003, and, as I said earlier, the next line, the cost of III -- or Class III or Class IV is again at USDA's announced price. So in this cost of raw milk, those two numbers do not include any premiums, co-operative handling fees, or anything of that nature, it is simply the Class prices.
The next four lines that we have, and we'll deal with them one at a time, containers: this, again, assumes that for this pro forma handler, that we're selling this product in plastic gallons, and from my earlier exhibits, we reflected the container costs from plant C, from Exhibit 25(a), and the plant C, as you'll recall, was a 5-million-

pound-per-month Class I operation. So that's the cost of containers.

Plant and overhead was extracted from that same exhibit, at the same per-gallon cost. Shrink, the next item, was extracted from that same exhibit and is reflected here.

And then delivery. As you remember, 25(a) did not deal with a delivered product; we had a dock price in that scenario of exhibits. So the delivery cost here of $1,832,000 is determined by -- I determined that what we needed to do is reflect an average delivery cost, because the -- this type of handler would be selling to different outlets, convenience stores, small stores, we heard some testimony about serving coffee shops and retail customers and other outlets, and from our database I determined that the average cost for this type of handler in this type of geography that we have in Order 124, 37.24 cents per gallon is what's reflected for this average delivery cost.

And then the next and final two steps in this process of pro forma would be to total the operating expenses, and as we can see here in column 1, the total is $9,914,000, and then to arrive at a net income before income taxes, we subtract the operating expenses from the revenue and we arrive at a bottom line of $694,000.

Q. And the bottom line for the middle column and the right column, the larger columns, would be as indicated on the first page of Exhibit 68; correct?

A. Yes, that's correct. And there the process for each one of those columns is identical, the only difference is the size, so there are more gallons in column 2 and 3.

Q. Now, let's just talk about delivery costs just a minute. To the extent that the top line -- that you used Mr. Ellis's testimony, the only testimony we have in the record about wholesale costs at any of these producer-handlers, to the extent that you used that for the top line and Mr. Ellis acquired the product at the plant dock and delivered it himself, by including delivery costs and operating expenses here, have you been as conservative, in essence, as you could possibly be about delivery expenses here?

A. Yes, I think we have been conservative, and it's also been my experience that when a circumstance like a dock pickup takes place, we have a reduction, generally, of some extent, to some extent, of the -- of the sale price, you get some credit for picking up at the dock. There's still a cost associated with a dock pickup, the truck has to be loaded, there's a security issue of having someone other than an employee enter your facility, so they -- there's generally -- however, there's generally an additional discount, and I mention that in my Footnote Number 5.

Q. But to the extent that sales at any of these producer-handlers locations were made at the plant dock, such as, you know, with Mr. Ellis, those plants would not have anywhere near the 37-cent-per-unit delivery cost, would they?

A. No, they would not, clearly.

Q. So for instance, with respect to Smith Brothers, if 70 percent of their sales are to home-delivery distributors of the -- such as Mr. Ellis, their operating statement would reflect considerably less delivery expense than you do on Exhibit 68; correct?

A. I would think that they definitely would.

Q. And of course the same thing would apply to any other volumes to the -- of any of the -- the three producer-handlers, to the extent that they were selling from their dock as opposed to delivering them to the customers' location.

A. Yes.

Q. Now, let's look at the second page of Exhibit 68 just a minute. Have you -- I think you've probably covered all of your assumptions in describing the first page of Exhibit 68, but could you just review those, to be certain that you've explained all of the assumptions that went into your calculations.

A. Yes, I'll be glad to, and we'll make this -- make this quick.

Footnote 1, as I said earlier, is the basis upon which we pro forma'd and calculated the revenue under consideration here, and again, USDA publishes on a monthly basis out-of-store prices, and I've referred to that -- that document. And we used the 7 months, January through July, of '03 for Seattle, Washington, and Portland, Oregon, and then reduced those out-of-store prices by 40 percent, to reflect a wholesale or into-store price.

The allocation between Class I and other classes, again, I extracted that 85.5 and 14.5 from the -- from this hearing record, from previous witnesses.

The operating costs, Footnote Number 3, I extracted from my own exhibit, 25(a), which was presented in Arizona.

Footnote 4, it should be clear to everyone that the cost of milk that's reflected here is the -- is a regulated cost of milk, it's Class I or the lower of III or IV, so this is not a cost to produce or a market blend; this is the Class price for milk, without regard to any premiums, market administrator fees, or any costs of that -- of that sort.

And then Item Number 5 is the delivery cost, from our firm's database, for average deliveries for plants that are handling various kinds of customers.

Q. Okay. Now, going to the revenue mix just for a minute: to the extent that any of these producer-handlers have sales of Class II products, you know, valuated Class II products, ice cream or, you know, sour creams or creamers, you've not taken that into account at all; correct?

A. That's correct.

Q. Okay. So those Class II values are higher than Class III and IV minimum values, are they not?

A. Oh, yes. There's more value to that -- that part of the business.

Q. So, you know, the gross sales -- you haven't been able to capture, you know, the total gross sales on any of these businesses because of your -- the limited information available for the pro forma.

A. That's correct. However, one of the requirements that one has in presenting pro forma information is that -- that it passes the "smell test," and that's one of the -- one of the things that we did when we finished this -- this analysis, was to look at it, does it make sense, is this a reasonable set of assumptions and conclusions that can be reached from this, and it's my opinion that this is a reasonable presentation of what a handler of these sizes would -- would realize.

Q. And that conclusion is made on the basis of your experience in dairy plant cost accounting for how many years?

A. This whole adventure began in 1975.

Q. And you have in your database -- you may have testified to this earlier, but just so we're clear on it: approximately how many plants?

A. A hundred and fifty.

Q. Let me just ask you a few other questions, then, Mr. Herbein. Dr. Knutson made some comments about your previous presentation. Did you hear his testimony, by the way?

A. Yes, I did.

Q. And do you recall that he made a comment about the statistical validity, or something to that effect, of your previous study? Do you recall that?

A. I remember that, and I've read his -- read the transcript of his testimony also, to make sure of my recollection.

Q. Okay. Now, from a -- as an accountant, certified public accountant: what standards does the accounting profession have for selecting data to -- what methods can you use to select data to depict data and arrive at conclusions about it?

A. There are two, two methods: one is statistical selection based on the use of random number tables, as one method; and judgmental selection is also an acceptable method, depending upon the universe that you're studying.

Q. Okay. And so when -- when accounting work is peer-reviewed, it's peer-reviewed under whatever method it utilized, I assume.

A. Yes. In a peer review of CPA firms, that would be one of the -- not "would be" -- that is one of the subjects that the peer review team looks at very carefully, is the universe that's being studied in -- for example, if it's verification of accounts receivable or inventory: what did you study? how did you do it? how did you decide what study -- what items needed to be -- need to be reviewed? so that you can be comfortable that the inventory and/or receivables are properly stated.

Q. Okay. What method did you use to select the data that went into your study that was presented in Exhibit 25 and your earlier testimony?

A. This -- the selection methodology used was: judgmental selection.

Q. It was not presented as or intended to -- or represented to be a statistical random sample of some sort.

A. No, not at all.

Q. Was it a sound -- did you use the standards of the profession in your applying the judgmental method?

A. Yes, I believe so, especially in light of the universe to be studied here. When we think about -- when I think about -- strike that. When I reviewed Professor Knutson's comments and thought about and looked at what I did, I believe that the use of statistical sampling to select the plants that I was asked to look at would have been wrong because what was really important here was to present to USDA information for plants and types of plants of various sizes, and when one uses statistical sampling, if we took all of the 300 plants in the country and we assigned them random numbers and selected them on that basis, we could very easily have in our study a plant in Milwaukee that produces and sells their milk in glass bottles, which would be a whole different ball game than the kind of plants we're studying here. So I believe it a far superior method to use judgmental selection, and what I did is I went into our -- our database, which since -- as I said, the key element was size, that we chose to study, and looked at the plants that were of the size that we decided to study, as shown on the -- Exhibit 25 and the other letters to 25, and I personally know these plants and was able to select plants from our database based on the size criteria that fit the need of this study.

Q. And let me ask you one -- I want to ask you one very specific and very important question about your judgmental selection process. Did you know the cost of the plants that you selected for your study before you made --

identified the plants to be utilized?

A. No. The cost did not at all enter into the selection process, it was -- the size and the type of plant was the selecting criteria.

Q. Now, let me ask you just one question. You were not here this week, previously during this week, correct, in the hearing room?

A. I arrived at the very, very end of yesterday.

Q. Okay. You did not hear Mr. Hettinga testify.

A. No, I did not.

Q. Okay. Did you have the opportunity to review his written testimony, which was presented by Mr. Ricciardi?

A. Yes, I did, I had an opportunity to -- to read his testimony.

Q. Okay. Do you -- I just have one question. There's a comment made on -- about that, regarding the cost of -- per-unit cost of processing, packaging, and labeling on -- I think it's on Page 11 of the -- of that testimony. Do you have any comments or observations, from a professional accounting perspective, with respect to that comment?

A. Yes, I do, and I think it's important for everyone involved in this process to understand the -- what appears to be a criticism, but I believe it is a misunderstanding.

The way I interpret Mr. Hettinga's testimony is that when a filling machine is running, packaging equipment in a plant, on a per-package basis, the costs of the label, for example, could be very, very similar, if not the same, on a gallon and a half-gallon, and perhaps even on a quart, but -- so if that's 1 cent for a gallon and 1 cent on a half-gallon and 1 cent on a quart, my statistics are presented on a gallon-equivalent basis, so that we take into account, as you must, for proper cost accounting, the volume of the package.

So when we talk about costs per gallon, if it's 1 percent per gallon, it's a half a cent per half-gallon and it's a quarter of a cent for a quart, so that -- so that we don't have the record misled, and it's very clear to anyone in the industry that filling a gallon container on a volume basis is much more efficient than filling a quart, and the statistics from any public or private source would support that.

Q. Okay. I have one final question. When you did the pro forma study, you didn't have the opportunity to hear any of the testimony that was presented this week; correct?

A. That's correct.

Q. Mr. Hettinga's or anyone else's; right?

A. I heard none of that.

Q. Okay. Now, one of the witnesses this week was

Mr. Brandsma, from Edaleen, and he provided some additional incremental information about store prices and producer-handler -- their operation and their profitability.

I want you to assume that he testified that in Whatcom County, Washington, where they're located, the convenience stores that they service sell gallons of milk at 2.19 to 2.29 per gallon -- okay?

A. Yes.

Q. -- and that their sales to their stores are profitable.

A. Okay.

Q. Okay. Taking just current prices in this month, January 2003 [sic.], which -- for the order, which you have available to you the exhibit published by the market administrator of the minimum Class I cost per gallon on --

THE COURT: When you said 2003, did you mean 2004?

MR. BESHORE: 2004, I'm sorry. 2004. Thank you, Your Honor.

BY MR. BESHORE:

Q. You have that exhibit?

A. Yes, I do, Exhibit 62.

Q. 62. Okay. Now, have you had a chance to just, using January figures and those out-of-store prices, evaluate whether in your view, assuming a Class I cost, those sales could still be profitable to a producer-handler of the size that you're talking about in Exhibit 68?

A. Yes, I have.

Q. And what is your conclusion?

A. My conclusion is -- and I'll provide some detail to this calculation so that it can be understood. My conclusion is that the -- using the Class price for a 2 percent gallon of milk for January of 2004, which Exhibit 62 reflects at 1.0402; then using a plastic gallon cost, from my exhibits, for a handler of the 5-million-pound-per-month size, which is a cost of .1420; using a plant cost, from that same exhibit, of .4710; and a shrink factor, to consider that condition in a plant, of .0180; and for delivery to a convenience store chain, a cost of 28 cents a gallon for that delivery: the ending profit on a per-gallon basis would be 7 cents.

So I believe that that witness's testimony that he had a profitable transaction, it -- based on that -- based on my analysis, it would be profitable at the Class prices.

And the 7 cents a gallon would be about 3 and a half percent on the bottom line, before tax, which ironically is the statutory-mandated profit in the state of Pennsylvania, by the Pennsylvania Milk Marketing Board.

So it made sense to be a normal transaction.

MR. BESHORE: Thank you. No other questions for Mr. Herbein on direct. I would like to move the admission of Exhibit 68.

THE COURT: Any objection to its admission?

MR. YALE: We would object until we have an opportunity to cross-examine, Your Honor.

THE COURT: Well, whatever you cross-examine, it'll probably still be admissible, just be -- you know, it might affect the weight that the Secretary gives it, so --

MR. YALE: Would you just note our objection.

THE COURT: Your objection is noted, overruled. Exhibit Number 68 is admitted into evidence.

(Exhibit No. 68 was received.)

THE COURT: And the witness, I presume, is available for cross-examination. Mr. Ricciardi, Mr. Yale, who's going to go first?

MR. YALE: Just a minute, we're trying to figure out our order here.

(Pause.)

MR. YALE: Benjamin F. Yale, on behalf of Mallorie's Dairy, Edaleen Dairy, and Smith Brothers Farms. I tried not to be first, but I still end up being first.

CROSS-EXAMINATION

BY MR. YALE:

Q. Good afternoon, Mr. Herbein.
A. Hello, Mr. Yale.
Q. I want to talk about this Exhibit 68. You've talked about how it met standards, I guess, of a CPA for a pro forma?
A. Yes.
Q. Would you recommend that a person enter into a buy or sell agreement based upon the information that's presented here? Is this sufficient to enter into that type of a decision?
A. The use of a pro forma to determine a buy/sell arrangement, in the context of milk, would certainly be something that could be considered, and it is many times done, customer and processor meet and review what their milk program is going to be on a pro forma basis, so that it's not an unusual consideration. In most cases, when it gets right down to doing business, it's done, obviously, on an actual basis, using actual numbers.
Q. So the point of it is, is that this is not -- in the ordinary course of business affairs, this in itself is not of that standard that you commonly provide your clients to make business decisions; right?
A. Not exactly. It is a -- the use of pro forma in negotiating, again, a milk deal, milk arrangement, is -- would be one of the factors. This is not a complete normal

decision-making set of documents or operating documents, but it would clearly be a consideration, and an appropriate one.

Q. Now, you referenced your -- I think in your digression from the 2.19 a gallon, or whatever, price, you -- first of all, you used your exhibit that identified -- what you identified as costs for various size plants, it was testified, I believe, in Phoenix. You recall that?

A. Yes. That is --

Q. That's where you came up with the numbers.

A. That's correct.

Q. And you would agree, would you not, that even with your limited data, those were averages within the range of the size of that plant? Right?

A. The 25(a), from Phoenix, in the 5,000-pound-per-month category, was the average cost for -- I believe we had four plants in that -- in that grouping.

Q. And I think we've already been through it. There's none from the Order 124 area; right? I mean, this is out of your database and did not include a plant out of 124; right?

A. That's correct. However, you'll recall that I adjusted the costs to reflect -- to localize the costs to the standards of living -- cost of living into those markets.

Q. But not to adjust to the methodologies of business practices within the local economy, in the labor markets within that local economy, or the cost of energy in that local economy; right?

A. No. My adjustments would have done just that, they would not have reflected business practices, but they would have reflected utility costs and labor costs. That was precisely why I made that adjustment.

Q. Okay. So -- I want to come back to this Exhibit 68 so I understand it. What -- as I understand what you're saying is, is that a plant of 3.5 million pounds per month, selling milk under this mix -- assuming that that is in fact the mix that they have for that Class; right? We don't know that for a fact, but we're assuming that; right?

A. That's an assumption to the pro forma.

Q. Okay. And then you -- they have to pay out their costs based upon their classified use, right? The raw milk price for their classified use, into the pool. Right?

A. Yes, in this case, that's the assumption, correct.

Q. Okay. Now -- and I think you just testified that based upon a snippet of information that came out of Duane Brandsma's testimony, about 2.19 for some milk at the convenience stores, that that appeared to be, based upon your analysis, a market price at the retail level that would be commensurate with milk being sold at a Class I price as set up by the market administrator plus your costs of plant manufacturing and reasonable distribution, and a profit, and a markup for the store; right?

A. The -- yes, as to the Whatcom County analysis, that is precisely what we've concluded from the analysis that I did.

Q. So what it reflects is that those sales in that particular case most likely represented sales by the producer-handler that were using or at least not taking away from the Class I prices in the marketplace, even though they weren't required to pay that; right?

A. That's one of the frustrating parts of this proceeding, is we don't -- I don't know that. I'm left with making assumptions for the calculations. I really don't know what their into-store price was, I've made -- I've had to make assumptions of that. We only know the out-of-store price from the testimony as I understand it.

Q. But we notice in here that the analysis, though, that you just did on Mr. Brandsma's testimony at least does not suggest that they're selling it at less than Class I -- using less than Class I prices; right?

A. Yes, that's correct.

Q. All right.

A. It appears that you can have a normal profit and include the Class I price -- cost, rather -- in that determination. That's the conclusion that -- one of the conclusions you can reach from that analysis.

Q. And there's -- I don't know how much of the testimony you've read or has been related to you, but the testimony has been -- at least from some of the producer-handlers, was that they do not try to sell below the Class I price. In fact I think one of them even said, "I take the Class I price plus my costs plus distribution plus packaging plus a profit and use that to set my prices for my customers," right? Are you aware of that testimony?

A. Other than the testimony about Whatcom County, I unfortunately did not hear most of the producer-handler testimony.

Q. Okay. For the moment, though, let's just -- you have no reason to believe, for what you know, though, that any of the producer-handlers do in fact sell at a Class -- less than a Class I price at this point; right?

A. I really don't know.

Q. Okay. Now, basically, as I see it here, your raw product -- in a sense, you might have a cost of goods -- it depends on where you draw the line, but let's just use it on the raw product issue. You've got the price that you pay into the -- that you sell it for, and then you've got back -- I mean you sell it, and then you would pay a classified price for that; right?

A. Yes.

Q. Now, the assumption -- now, this was on the plant side; right? You've done no tie-in to the farm side; right?

A. This is the plant side, that's correct.

Q. And I think your assumption, and I think even some of your testimony in Phoenix, was that then the producers get the blend price, the farm gets the blend price, and then they have to make it or break it at the farm level based upon that blend price. Right?

A. Yes. A regulated handler -- a regulated farmer would receive the blend price, that's correct.

Q. So in this particular situation, if they were fully regulated, they would get back -- the farm part would get the blend price, assuming that they're two different entities, but for the moment we'll do that. They get the blend price; right?

A. The farmer would get --

Q. And then -- but the -- and the plant -- but the plant pays in the classified price.

A. Farmer gets blend, plant pays Class.

Q. Now, as I recall, you haven't done any accounting for farms, to speak of; right? I mean, you don't really know farm costs or anything of that nature, right, on a -- as extensively as you know plant costs?

A. The firm and my personal involvement with -- on the farm side of things is considerably less than on the processor side. However, the -- you can't be in the dairy business, in the dairy consulting business, like I am and like our firm is without paying attention to the main -- the major raw material that the processor buys, so I do follow costs to produce statistics as published by USDA and the Pennsylvania Ag Statistic Service and have attended many, many hearings where those statistics are presented, and we do represent several dozen dairy farmers in our -- in Pennsylvania, in our practice. So I have some exposure to it.

Q. Isn't it safe to say, with that exposure, that during the year 2003, that for many farms, we can't say, you know, percentages, we don't know that, we don't have all the statistics nationwide, but by and large the cost of production exceeded the blend prices that they were receiving? Right?

A. I've seen some of that, yes.

Q. So when there was producer-handler testimony to the fact that there were months and periods of time in which their costs of production exceeded the blend price, you would not find that, in general, unbelievable, would you?

A. And I think I've heard some of that testimony, and I would say that cost to produce is very dependent upon the size of the -- of the farm operation, so the smaller farmer would be less likely to be -- strike that -- would be more likely to be above the blend than the very large producer, where he would be at or perhaps below the blend.

But 2003 was a challenging year for farmers, there is no question about that.

Q. So if you take your pro forma and you take the position that they are selling their milk, basically, at the Class price, and I think even your assumption here is that it's at that level, and instead of -- the difference there would be that their cost of their raw milk or their cost of sales is what they're actually paying on the farm; right?

A. For a producer-handler, that's correct.

Q. All right. And to the extent that they are approximating those prices now, a change by the Secretary would mean that they have an additional cost of the difference between the classified price and the blend into the pool, that they don't get back; right?

A. Your assumption is that their cost to produce is at or above the Class price now.

Q. That's correct.

A. And I think the -- and maybe I misspoke, so I want to make sure that we're clear on this communication.

The -- I thought that the question earlier was: if I thought -- if I was aware that the cost to produce was above the blend price.

Q. That was right, and I forgot to take you to the next step. There's even some testimony that at times it exceeded the Class prices.

A. I have not seen that sort of an analysis. I've seen statistics where cost to produce is above blend, and that I would agree with. Class above the Class prices in a heavy Class I situation, as this pro forma is prepared, I -- I would -- I would question that.

Q. Are you aware of what the differential is in Seattle, the Class I differential?

A. Not without looking.

Q. If I told you it was a dollar-ninety, do you know if that's correct or incorrect?

A. I certainly -- I don't see any lawyers jumping up and objecting.

Q. So with the low prices last year, I mean, it could have been a very low Class I price; right?

A. Yes, we did have a low Class I price in -- I mean, I studied 2003, and we had what I would label "a low Class I," there isn't any question.

Q. And then there was some -- and Class II is the Class IV price plus 70 cents?

A. Yes.

Q. And there were some Class IV prices in the 8-, 9-dollar range?

A. Yes.
Q. And do you know many farmers, even of the larger size, that were producing milk at 10 dollars?
A. There are costs to produce numbers, in America, of -- in that 10-dollar range.
Q. Small percentage, though, right, of a very large size?
A. Yeah, large -- as I said, the larger the size -- and some of it is also determined upon the age of the operation.
Q. And there's a lot of variables, but the point of it is that the price -- the classified prices last year were -- and the record will reflect what they were, but they were low; right?
A. Yes. And I would say -- and I think this is in response to last year's price, I don't want to lecture here at all. I think it's important that we focus on some more average kind of activities and not focus on just the very lowest or the very highest, because that would lead the Secretary to, you know, perhaps the wrong conclusion, so I think it would -- you know, I'd encourage all of us to, you know, take a -- take a view of a little longer time period.
Q. But your statistics, or I mean your table, 68, only deals with January through June or July of 2003, though; right?

A. That's correct.

Q. You chose that period.

A. Yes, I did, and I --

Q. And you chose that in the exhibit that talks about the cost of plants and looking at an analysis of box sales in Phoenix, right, for January through June?

A. Yes.

Q. Okay. Now, to the extent -- that is, if we look at it from a producer-handler standpoint, that's going to make the change, and assuming this is accurate, okay, their cost of production, as compared to the classified prices that they have to pay, they'd have to make an adjustment to reflect that; right? Because all they're going to get's the blend price.

A. They would -- we're separating producer-handler into two pieces?

Q. Right. I mean, try to look to see whether this would have an impact on producer-handlers.

A. Well, on the producer-handler -- and that's a good question. On the producer-handler, on the plant side of things, his operation would be precisely what I'm presenting here.

Q. Right.

A. -- precisely, because we've included the Class price.

Q. Right.
A. So the payment to the pool is in this P & L as an expense. On the production side, the cost to produce would be exactly the same --
Q. That's right.
A. -- as it is now; and if their cost to produce was the blend or lower, their -- they would be at the same spot of profitability, because they would be receiving that blend price.
Q. But what -- in the past they were receiving the classified price.
A. Well, in the --
Q. So they're receiving -- they're receiving right now, at the farm side, they're receiving the classified price for their milk.
A. When they sell it.
Q. When they sell it.
A. When they sell it at retail -- when they sell it at wholesale.
Q. Right.
A. Yes. I think that the bottom line of this analysis and the reason that we chose to do this pro forma was to -- to test the theory of: is the business of the regulated -- excuse me: is the business of the producer-handler viable when regulated? That was something that we

thought was important for this proceeding.

Q. All right. Now, let's take that step. But if the testimony was that their costs were at or near the classified pricing, okay, as it stands today -- which they get to keep all of, right, because they don't have to pay into the pool. Right? They keep all their income. Correct?

A. That's my understanding, yes.

Q. And they have their Class I sales, that you're approximating; right?

A. Yes.

Q. The difference would be that they have to pay the difference between the Class price and the blend price into the pool, that they're not paying now; right?

A. That would be the difference. And again, just so that everyone's clear, that is -- that is what's in these numbers on the pro forma, on Exhibit 68.

Q. They're already included in here?

A. Yes, they are.

Q. And the total enterprise, with the farm --

A. I don't have any farm information.

Q. I understand that, but I want to bring this up, is that with the farm level, they're receiving -- and it's -- because it's one entity and it's hard to separate, right? I mean, you know, you can do enterprise accounting, but there's still -- it's still one tax return and one net profit, right, you would agree with that?

A. That's generally how it's done.

Q. So you start with the gross sales, that you've talked about, okay -- PD. We're forgetting that they're regulated. PD. They have their plant costs, their distribution costs, the costs associated with their marketing, and what's left comes back to the farm, whatever that is. Right?

A. That'd be one way of looking at it, yes.

Q. Okay. Well, let's look at it that way for the moment. Okay?

A. Okay, I will.

Q. Now, the way that you have described that is, the difference now -- I mean they -- at the point of being a PD, they don't have to pay anything into a pool. Okay? They get it all themselves. I think that's been the whole dispute here.

A. And that's my understanding of how the operations are now.

Q. All right. Now, if the testimony shows that their costs have been approximating -- their cost of production at the farm has approximated the Class prices -- okay? Are you with me?

A. I'm with you.

Q. Okay. -- then this scenario, in terms of the profitability of the plant and their operation, doesn't change, does it? They would be profitable as a total enterprise, by the amounts that you have here; right?
A. That's correct. If their cost to produce --
Q. -- is at the Class price.
A. -- is at the Class price.
Q. Okay. Now, moving that -- everything the same, but moving from the PD to the regulated handler -- okay?
A. Yes.
Q. -- the difference now between this and what we just talked about is, is that they have an additional change now, because instead of paying that classified price to the farm -- right?
A. (Nods head.)
Q. -- they're going to have to pay the classified price to the pool, and the pool's going to pay back a blend price. Right?
A. Yes, that's the way it works.
Q. So now we've got the difference between those two prices, that in a sense is going to be a cost to these producer-handlers -- again assuming that their cost of production is at the classified price.
A. Your analysis, you know, includes a very large and key assumption, and that is --

Q. I understand that. We're going to get there.

A. -- and -- if I would just finish, please.

-- the assumption that the Class -- that the cost to produce milk on the farm is equal to or approximately equal to the Class value of that is something that I really -- I have -- I can't comment on because I don't know.

Q. I'm not asking you to.

A. Okay.

Q. All right. I'm just asking you to assume it.

A. I will.

Q. Okay. Now, the record has reflected that during this -- roughly this same period, that the average difference between the blend and the classified pricing has been about a dollar-seventy a hundredweight, and it varies month to month, right, you would understand.

A. (Nods head.)

Q. Okay. So if you were to take, for example, the 3,525,000 pounds of Class I per month, times a dollar-seventy --

And that may not be the right -- it may be a little -- a number a little higher or a little bit lower, but just to keep the math simple we'll say a dollar-seventy.

-- what do you get? Do you have a calculator there? You do have a calculator; great.

A. The -- just to -- the dollar-seventy is a per-hundredweight.

Q. Per-hundredweight.

A. So we have 35,250 hundredweights per month, times a dollar-seventy, is 59,925.

Q. And that times 12 is what?

A. 719,000.

Q. Okay. So that exceeds -- for this moment, assuming that the classified pricing is what their cost of production is, that exceeds their current profit, under that theory; right?

A. 719,000 is larger than 694,000.

Q. All right. Now, the only way, with this change that's being proposed, in which that can turn from a negative number into a positive number, is to the degree that their cost of production is less than the classified pricing; right?

A. That would be one element. There is obviously another element.

Q. Which would be --?

A. Increase in their sale price to their wholesale customers, which -- which is a -- that is an issue that the statistics that I've looked at in this market would indicate the prices do move with the federal announcements, up and down.

Q. They move up and down. But it's also -- I think if you looked at the statistics -- did you look at these national statistics of retail price, is that where you got the number?

A. Yes.

Q. And you'll notice that Seattle was one of the highest markets in the country, wasn't it?

A. I did notice that.

Q. Yeah. Although it had one of the lowest Class prices. I don't know whether you -- you're probably not -- didn't see that, but, you know, it's one of them.

Now, with that, the probability of a small producer-handler being able to change the market -- it's a very competitive business; right?

A. Sure.

Q. There are techniques, and some are better than others, at getting more out of the market than others, but that's pretty well -- you know, that's not going to be a major movement. I mean, you'd have to agree with that; right?

A. I would say that the -- as a market incurs additional costs -- and I'm not talking about just the producer-handlers but the entire fluid milk market. As they incur additional costs, they pass them through the system to their customers. Some struggle, sometimes, to have that happen, but that does happen.

So I would say that in addition to the cost to produce going up or down, the price into the stores or to the customers, whoever they are, is the other source of revenue that a handler would have.

Q. I agree with that, but what I want to point out -- but for your static analysis for this period of time, to change that, we would have to change the cost of production; right?

A. Again, not to be repetitive: either that or the sale price to the customers.

MR. YALE: Thank you.

THE COURT: Mr. Ricciardi, do you have some questions of this witness?

MR. RICCIARDI: I do, Your Honor. Do you want me to get started or do you want to look at whether or not you're going to take a break?

THE COURT: It's too early for a break.

MR. RICCIARDI: Okay. That's fine.

THE COURT: Unless someone really needs one. Does anyone need a break?

(No response.)

THE COURT: Let's keep going for a while.

MR. RICCIARDI: Al Ricciardi, for Sarah Farms.

CROSS-EXAMINATION

BY MR. RICCIARDI:

Q. Good afternoon, Mr. Herbein, once again.
A. Hello, Mr. Ricciardi.
Q. Nice to see you. One of the things that CPAs will also do, in trying to do an analysis, is to rely upon actual data if it's available; correct?
A. Yes.
Q. And I think you testified at the previous hearing that there are -- there is at least one client in the Pacific Northwest that does business with Costco, and I assume that client is Wilcox Dairies?
A. Yes.
Q. So in your files at your firm, you would have the actual costs of production for the Wilcox Dairy operation; correct?
A. Yes.
Q. And also in your files you would have the actual invoices that Wilcox has with regard to any agreement it has to sell to Costco; correct?
A. No. Our engagements at Wilcox have not been that comprehensive, as to see contracts with -- with any of their customers.
Q. And for your engagement in this particular matter, you have not requested that information from Wilcox; correct?
A. No.

Q. And you have not relied upon the actual plant data for plant costs, transportation, et cetera, in your study, as part of Exhibit 68; correct?
A. 68 has really nothing to do with a Costco-type analysis. That -- that analysis was our Exhibit 25(e) in the Phoenix --
Q. You didn't use any actual data from Wilcox for Exhibit 68; correct?
A. That's correct.
Q. And one of the conclusions that you drew in Phoenix was, essentially, that with regard to box stores -- and Costco would be one of those, in fact Costco was the one you were talking about -- that a regulated handler could not compete with a producer-handler for that type of business; correct?
A. Or a producer-handler would have a substantial advantage, if you look at it from the other side of the coin.
Q. I think what you actually testified to is the regulated handler couldn't do the business because it wouldn't be profitable for them, and I can find that testimony, if you'd like me to.
A. Yes. No, I think that's -- I think that is the conclusion you can reach from my study.
Q. Wilcox makes a profit; correct?

A. That's really a proprietary issue that I'm not authorized to discuss.

Q. Wilcox is a reasonable operator; correct?

A. I would think so.

Q. They're efficient; correct?

A. Yes.

Q. They would not continue in business if they were losing money; correct?

A. It would be difficult.

Q. So we can make an assumption, therefore, that they are in fact profitable and the business that they have with Costco is profitable; correct?

A. That would require a detailed analysis of Costco and all the other elements of their -- their business. It's been my experience that sometimes companies survive and sometimes even prosper with having one segment of their business as being very profitable, another segment not being profitable, and I haven't made any analysis of Wilcox in that regard.

Q. So we can't -- given at least that information, we can't take a broad conclusion, as Exhibit 25(a) attempts to, that in fact a regulated handler can't compete with a producer-handler for business such as Costco, can we?

A. No.

Q. Okay. And --

A. Excuse me.

Q. Yes.

A. I think we can -- I had your question in reverse. I'd like to change my answer to:

You can, because my analysis is a detailed cost analysis, a specific cost center analysis, of what the likely outcome would be of a regulated handler doing business with Costco.

Q. And we -- I don't want to go through this in -- because we've done it before, but: that's based upon a database that you hand-selected from 150 down to 50 down to 20, and it has nothing to do with any producer-handlers in 131 or 124, and so we don't have actual cost data; that is your assumption based upon your own proprietary data. Correct?

A. Not with -- no. With respect to the Costco analysis, that's a specific cost study. You're taking part of your analysis out of my plant-by-size study and interphasing that into the like-Costco study, and they are two separate analyses, done, as I testified, really entirely different ways.

Q. I'm going to let the previous testimony stand, other than this, to make sure that I understand: that you don't have, in your study, in any of the studies, any specific cost data from Sarah Farms; correct?

A. That's -- unfortunately, that's the answer, yes.

Q. And you also -- your firm represents a regulated handler in Colorado, that also does business with Costco; correct?

A. Yes.

Q. And what is the name of that client?

A. Well, the -- a former supplier of Costco as -- Robinson Dairy.

Q. And you weren't here for the testimony of Mr. Hettinga, but he also testified that he was asked by Costco to provide a price and wasn't able to get the business because it wasn't even close to what Costco wanted, and so now we have other information that a producer-handler is having a difficult time in trying to price with Costco, at least in another market.

You didn't include any of that information in your original study; correct?

A. I wasn't aware of that -- actually, that might have been in the direct testimony of Mr. Hettinga, that I did read, but I did not use it in any way.

(Musical tone playing.)

MR. RICCIARDI: I'm enjoying the serenade.

(Laughter.)

MR. RICCIARDI: After the serenade, Judge, just give me a moment.

THE COURT: You can have it.

MR. RICCIARDI: It did break my concentration for a bit. It was lovely, though.

(Pause.)

MR. RICCIARDI: No further questions at this time. Thanks.

THE COURT: Ms. Deskins, do you or your colleagues have any questions at this time?

MS. DESKINS: I do have some questions. Charlene Deskins, Department of Agriculture, USDA.

CROSS-EXAMINATION

BY MS. DESKINS:

Q. On your -- I just want to understand, on Exhibit 68 you have -- it's for a 12-month period ended December 31, 2003?

A. Yes.

Q. Okay. And you said at the end, though, it came from a 7-month period?

A. That's correct.

Q. What's the 7-month period?

A. January 1st, 2003, through July 31st, 2003.

Q. Is there any reason you couldn't have used say a 12-month period starting from July 2003 and then going back 12 months?

A. That could have been done. I chose to use the --

as I think I said earlier -- the 7 months of 2003 because that's what was being utilized by myself and others in the earlier session of this hearing, so I simply didn't want to have different sets of statistics in the hearing record, I thought it would be clearer this way.

Q. Okay. And in order to get it for a 12-month period you did some sort of a factor, to change the 7, to normalize it for 12 months?

A. Yes. What I did specifically is: both for the cost of milk and the sale, I determined an average cost and an average net sale price for the 7-month period, simply by taking the 7 months and dividing the total by 7, and that gave me a number, and then I applied that to the number of gallons for a 12-month period, to give me revenue and cost of milk.

Q. Okay. And then for these other figures in here, such as shrink, you just used the same number for each month?

A. Per gallon.

Q. Per gallon.

A. It's -- these are all per-gallon numbers.

Q. Okay.

A. So then I -- I simply used an annual volume times a per-gallon number to get a full calendar year of results, of pro forma results.

MS. DESKINS: I don't have any other questions.

CROSS-EXAMINATION

BY MR. ROWER:

Q. Jack Rower, Mr. Herbein. Welcome back.

A. Thank you. Pleased to be here.

Q. In the plant overhead line item and the delivery line item, is labor cost embedded in there?

A. Yes. Both of those categories include labor, payroll, taxes, and all costs associated with employment.

Q. And labor costs are just averaged somehow, from across the country, using -- you used the CPI, if I understood --

A. Yes. What I did, as I testified to in Arizona --

Q. Yeah, I apologize if I'm asking you to repeat.

A. That's fine. The statistics come from Exhibit 25(a), plant C --

Q. Okay.

A. -- and there is an "Order 124" column, and that column was calculated by taking information from our database and adjusting it to the local costs in the Seattle-Portland region, using a CPI factor, so that if in my database I have New York City and Miami, I've adjusted to Seattle and Portland based upon the respective CPI difference in those regions.

Q. The reason I ask is, Mr. Yale in his cross-examination was asking about business practices, and in your -- to your knowledge, are the plants in Order 124, the larger plants, especially subject to collective bargaining agreement, are they unionized?

A. Yes.

Q. And how would that compare, in your opinion, to producer-handler operations which may or may not be, I mean in your experience?

A. My experience, I've never encountered a producer-handler that was organized -- that had an organized labor contract, and the dairy industry pretty much throughout the United States has a heavy preponderance of organized labor, a lot of Teamsters contracts, throughout the country.

Q. And how would you expect that that might affect a comparison of 124 as it is versus 124 as it appears -- regulated handlers in 124, Order 124, as it appears in your pro forma, would that make a large -- would it skew the results somewhat here?

A. I would --

Q. -- especially as you get to the larger plants?

A. I think there is -- I think you're on an area that would have an effect and my costs would have a union taint to them, because the majority of the companies in our database are union. So I would say that the localized --

Q. They would be biased --

A. -- wage -- excuse me. The localized wage level in 124, in a producer-handler, would be slightly lower because of the lack of union influence.

Q. And those kind of influences just wouldn't be reflected in the use of the CPI on your data overall, those localized --

A. The statistics, I -- as a matter of fact, the labor statistics that are included in the data that I used for adjustment would reflect whatever portion of region is subject to organized labor, because they use average labor dollars, so I think it would be -- it would be in there, but I think we're comparing that to a part of the market, that being producer-handlers, that are largely non-union.

Q. Exactly, yeah. That was my point.

A. So I think that when we bring these numbers for labor into 68, we probably overstated the labor cost to some extent.

MR. ROWER: Thank you very much.

THE COURT: Any redirect? Mr. English.

MR. ENGLISH: Charles English, for Shamrock Foods and Dean Foods.

REDIRECT EXAMINATION

BY MR. ENGLISH:

Q. Just so the record is clear, and I'm not sure what your answer actually was to the question, but you were asked a question or two by Mr. Ricciardi with respect to Mr. Hettinga's testimony, for which you weren't here yesterday, and as part of that he did not -- and this had to do with the idea that Mr. Hettinga had been solicited by Costco for business, outside of Order 131.

As part of that, he did not tell you that Mr. Hettinga acknowledged that that was not California, that the market -- that solicitor for Costco was not California, but beyond that he refused to disclose where the market was.

In that event, given not knowing where the market is, can you reach any conclusion about the ability of a producer-handler in Arizona to compete on Costco business somewhere outside of Arizona and California?

A. I sure can't.

MR. ENGLISH: Thank you.

THE COURT: Mr. Beshore, you had one?

MR. BESHORE: Just one question.

REDIRECT EXAMINATION

BY MR. BESHORE:

Q. The study that you did in Exhibit 25, testified to down at -- in Phoenix, with respect to the Costco sale, was an Order-131-specific study, was it not?

A. Yes.

Q. And it started with known out-of-store prices in

Phoenix as the top line; correct?

A. Yes. The 3.29 was an actual price that was obtained from the stores.

Q. Over a period of months, the months reflected in the table, whatever it is.

A. Yes.

Q. Okay. And the -- you know, the cost -- the milk price was the Order 131 price, and it was all Order-131-specific, was it not?

A. Yes, January to June of 2003.

Q. Okay. So when you're asked whether Wilcox's sales in another order don't show something about that, you're dealing with apples and oranges, aren't you, or something like that?

A. Yeah. That would be -- it would have been wrong to include Wilcox's milk costs because we were looking at the other order, 131.

Q. And if you were going to do a study in 124, you'd have to have all the information about 124 that you -- you know, that you had for 131, and you didn't do any study in 124 about -- like that.

A. That's correct, I did not.

MR. BESHORE: Thank you.

THE COURT: Anything further? Go ahead.

MR. MILTNER: Ryan Miltner, for Mallorie's Dairy, Smith Brothers Farms, and Edaleen Dairy.

REDIRECT EXAMINATION

BY MR. MILTNER:

Q. Good afternoon, Mr. Herbein.

A. Hello, Ryan.

Q. You had a brief comment which addressed Dr. Knutson's criticism of your data selection. Do you recall making some comments on that?

A. Yes, I do.

Q. Okay. I'd like to follow up on that just a little bit. You described two methods for choosing data from your database, and I think you called them judgmental selection and random selection, and you indicated that both were proper methods of selecting data, depending on the type of study you were conducting. Is that accurate?

A. Yes. And I -- if I said random, I intended to say "statistical."

Q. Okay. And that may have been my substitution, not yours.

And you indicated that when you may have a study peer-reviewed, one of the things they look at is: to ascertain whether you chose the correct method of selection; is that correct also?

A. Yes. Yes, peer review of our CPA firm by the peer review team that is selected to look at our way of doing audits.

Q. And will they -- so they'll look at the data you've compiled and make a determination as to whether you made the right pick in -- no pun intended, but the right -- you were correct in using a judgmental selection versus a statistical selection.

A. Yes, that is one of the -- one of the elements that the peer review team reviews in reviewing audit work done by our firm.

Q. Okay. What will the peer review team look at, if you know, to make that determination, as to whether your selection was correct?

A. They -- and again, just so the record's clear: the peer review process of CPAs is performed on the ad test [phonetic] function engagements, meaning audits, and they -- and what they look at in that -- and I gave the example, I think, of inventory and accounts receivable auditing, they would look at: what is it that's being audited; they would look at: how was the selection conducted, what was the results of the selection and of the audit; and then there is a -- there's professional judgment that is applied by the peer review team captain, and they either conclude that your selection methodology was correct or incorrect.

Q. So they will want to know -- if it was a case of judgmental selection, they'll want to know what criteria you used to make your selections.

A. Yes, and that would be documented in the work papers, in the accountant's work papers, there'd be a memorandum to the file, something of that sort, that --

Q. Okay.

A. -- would explain that. And we have a series of checklists that we utilize to -- to document those -- those factors.

Q. And would they want to look at perhaps the total pool of data from which those -- those selections were made?

A. Yes. They'd look at the universe.

Q. And would they want to look at -- and they would get this perhaps by process of elimination, by -- but: what data was rejected in making those selections?

A. They would focus on the universe, what type of components are in the universe, and they would look at the extent of testing performed and the method by selecting the testing degree. They, as far as I've observed, and as far as the -- my training, you don't have to look at what you didn't test.

Q. But by knowing what the universe is, and the criteria, they will have some idea of what was screened out of the selection.

A. Sure.

Q. And if I recall your testimony in Phoenix, the

150 plants that were in your database contained proprietary information and you were asked some questions about the data that was in that database, that you would not provide because it was proprietary information.

A. Yes, that's correct, that's our agreement with our -- with the participants: that the data is not disclosed on an individual company basis.

Q. Okay. And the criteria that you've provided for the Secretary -- you were asked about the criteria that you used to select the 20 plants you chose, and you said that "The criteria we were looking for was plant size."

A. That was the primary criteria.

Q. Okay. And so if all we know is that you picked by plant size, and we know that there were -- there was minimal representation, if any, in the two orders affected by this hearing, those would be important criteria, in a peer review, to determine whether a judgmental selection was properly done, or even if a judgmental selection was preferable to a statistical selection; is that correct?

A. The peer review of this selection would involve looking at the universe, and the universe is our database, and one of the factors -- and that's why I said size was not the only -- was a primary criteria but not the only one. So for -- and I used the example of: in our database we have -- believe it or not, there are a couple of plants in America that put milk in glass bottles, and that would be something that would be excluded from the sample.

So another criteria that would be shown in our -- in our work papers is the product mix, and here we're talking about plants that were producing gallons and half-gallons in plastic containers or paper containers, so that would have been -- that would be another thing that the peer review would look at, I believe.

Q. And if I remember, we asked about product mix and what product mix was represented in Exhibit 25, and I don't recall what your exact answer was, but either you didn't have that information prepared or you weren't able to provide it, for proprietary reasons.

A. The product mix -- and I'll answer that now, and if I -- maybe I -- we didn't have proper communication.

The product mix in -- in the plants included in 25(a) would include all of the products that we've talked about here at this hearing, gallons, half-gallons, quarts. There would also be some school milk in those plants. So it covers the -- the normal array of products produced by a dairy plant of that size today, really anywhere in the country.

Q. And as far as the array of products covered, we may have that, but we don't know the actual mix as far as percentages of gallons produced compared to quarts or school milk.

A. No. No, I -- I mean, that data exists in my database, but I don't know that as I'm sitting here.

Q. And in fact that probably varies across your six categories, the product mix in column A may be very different from the product mix in column E or G -- or E or F.

A. Yes. It tends -- you'll tend to find in the larger -- in the larger plants, E and F, more gallons and half-gallons and less pints and half-pints.

Q. And since we're talking about peer review, and the Cornell study has also been brought up in this hearing: The Cornell study was a peer-reviewed study; is that correct?

A. I really don't know -- I don't know what review the Cornell study was subjected to, but it would clearly not have been subjected to a peer review in the context that I'm using "peer review." Peer review of CPA firms is an entirely different process than the peer review applied to an academic study at the university level. They're not at all comparable.

Q. Okay.

A. And I don't really know anything about the university peer review.

Q. Was the data you prepared, the report you prepared in Exhibit 25(a) and Exhibit 68, subject to any peer review, either academic or through an accountancy board?

A. No. And peer review occurs every three -- no -- for a couple of reasons, the primary one of which is: peer review occurs every three years, and it is an after-the-fact review, so our firm's next peer review will be the summer of 2005, so -- and would this assignment be selected for review? I have no way of knowing.

Q. When you have a compilation done by judgmental selection rather than statistical selection, is there any difference in the predictive value of that study compared to one that has been statistically selected, in your opinion?

A. No, none whatsoever. If the selection methodology being statistical or judgmental is correct, the level of confidence would be the same.

Q. Provided that the selection was correct.

A. If the selection's correct, the results would be comparable.

Q. When you were -- Dairy Farmers of America was the organization that contacted you to compile Exhibit 25(a); is that correct?

A. Yes.

Q. Do you recall when Dairy Farmers of America contacted you to compile that study?

MR. BESHORE: Your Honor, may I just object at this point. I think we've been constrained -- this is --

THE COURT: I'm going to sustain the objection.

MR. BESHORE: It's beyond the scope.

THE COURT: He's here to testify on Exhibit 68 today, and the questioning about -- there was a lot of questioning, as I recall, about his selection process and his payments [phonetic] and all that on preparation of the exhibit that he presented back in Phoenix, but I think for today you're going way beyond the scope.

MR. MILTNER: Your Honor, he's addressed Dr. Knutson's criticism of his selection and reintroduced that topic today.

THE COURT: But the question you just asked him was one that he was, I believe, asked -- I mean, I may be wrong, I don't claim to have memorized the 2500-page transcript that we had, coming in here, but just -- you know, maybe I'm just getting deja vu all over again, but I swear that I've heard this question asked of him, but --

MR. MILTNER: I don't recall that from the transcript either, Your Honor, and -- I don't recall, but if --

THE COURT: Well, you know, okay --

MR. MILTNER: -- can answer that, I'll --

THE COURT: If you want to ask him a question or two on it, I think -- I'm thinking you're overstepping it, but in the event that my recollection is wrong, and I don't have it all in front of me, I'll let you ask it.

MR. MILTNER: That's my last question on 25, Your Honor.

THE COURT: I will hold you to that too.

MR. MILTNER: Thank you.

A. I don't recall the specific timing except that we were all in Phoenix or Tempe, Arizona, at some point, and I was engaged a couple of months before then. I mean, I have a signed engagement letter that has a date on it, but I don't remember exactly.

BY MR. MILTNER:

Q. Okay. My last question deals with Exhibit 68, as promised, and the Department asked some questions about labor costs, and union labor in specific, and its inclusion in the operating expenses on Exhibit 68, and you made the statement that you are not aware of any producer-handler -- and I don't recall if you qualified it as producer-handler in the Pacific Northwest or any producer-handler -- that used union labor. Is it your testimony that you're not aware of any producer-handler that uses union labor?

A. That's my testimony, and just to be clear: I'm not aware of a producer-handler that has organized labor in the plant, in their distribution, or on their farms, but I haven't studied all producer-handlers in America. There could well be an organized labor -- I find it, with what I know about the industry, unlikely, but I -- you know, that's all I know.

Q. So you are unaware that Smith Brothers Farms employs union employees.

A. I'm unaware of that.

MR. MILTNER: I don't have anything else, Your Honor.

THE COURT: Thank you. Anything else, can I let this witness go? Mr. Rower, go ahead.

RECROSS-EXAMINATION

BY MR. ROWER:

Q. Jack Rower again, Mr. Herbein. Based on your studies and Exhibit 68 today, is it your opinion that the 3-million-pound limitation in Proposals 1 and 3 are appropriate?

A. Yes. My conclusion, after studying a lot, and looking at a lot of statistics, is that the size -- and this comes from the costing and economic analysis that I've done: as the plant gets bigger, its costs get lower, and the need, the economic need, to not pay into the pool or be regulated disappears because of the advantage of getting bigger. So I -- that's my conclusion.

MR. ROWER: Thank you very much.

RECROSS EXAMINATION

BY MR. TOSI:

Q. Thank you for appearing, Mr. Herbein. I'm Gino Tosi, with USDA here in Washington, D.C.

A. Good afternoon.

Q. Based on your answer that you just gave Mr. Rower to his question, to the extent that federal orders provide no regulatory exemption from pooling and pricing of regulated handlers that are above 150,000 pounds, how does your opinion square with -- to the extent that a handler, who distributes on routes more than 150,000 pounds, why the difference between 3 million pounds for a producer-handler and 150,000 pounds for what the order's referred to as "exempt plants"?

A. It's a good question. I haven't really thought about that or studied that at all. However, it seems to me that an issue would be the -- the producer-handler produces his own milk, and so that would be a difference from a processor -- a very small processor who was buying his milk. It would be a middleman kind of situation. But I haven't -- I really haven't looked at that at all, so I will have nothing further.

Q. And may I ask you a couple of hypothetical questions, that go something like this.

Based on your study of the issue and your participation in this proceeding, is there something about the nature of the entity that's called a "producer-handler" where there's the combination of own-farm milk production, their own processing, all done at their own enterprise and risk and distribution, that there's something in that mix of risks, when you combine the features of production with processing and distribution, that gives a degree of reasonable justification for why a level -- or a cushion, if you will, at somewhere between 150,000 pounds and 3 million pounds?

A. Yes. I think the justification is the decreasing plant costs as the processing volume increases.

Q. And in that regard, there's a certain amount of acknowledgment of the risk of production, production meaning the farm side of the producer-handler's operation, that enters into that mix, that would provide a reasonable justification for why to that level the Secretary should choose to or should consider not regulating the producer-handler up to that 3-million-pound threshold?

A. Yes, I think that would be another -- another factor to be considered.

MR. TOSI: Thank you very much.

THE COURT: You have another question, Mr. Yale?

MR. YALE: I have a follow-up on that one.

THE COURT: Go right ahead.

MR. YALE: Benjamin F. Yale, on behalf of Mallorie's Dairy.

RECROSS-EXAMINATION

BY MR. YALE:

Q. A follow-up on Mr. Tosi's question. As I understand your testimony today and at Phoenix, you have not done any study of the farm risk involved in a producer-handler -- is that right?

A. The farm risk -- none.

Q. So how can you now testify that it's 3 million pounds that there's a risk, that it measures off by the production costs?

MR. BESHORE: Objection to the question. He did not so testify. He's misleading the witness, it's a mischaracterization.

THE COURT: You know, without having -- I'm not taking exact notes on the wording of the question, but why don't you try rephrasing your question.

MR. YALE: I'll withdraw the question and restate it.

BY MR. YALE:

Q. You just answered that between 150,000 and 3 million, that there's a mix, I think the question talked about: there was a mix of a risk of a producer on the production side and a producer-handler, and the question is, is at 3 million, in that cushion, cover that risk so that at that 3 million, that the advantage of the production side -- the processing side, I'm sorry, offsets that production risk. I think that fairly states the hypothesis that was presented to you.

A. And my answer to that, Mr. Yale, is -- and was -- that when I look at the cost curve in the plant, I see a decreasing cost as the plant gets larger, and that is -- and at that point, of 3 million pounds, I believe that the producer-handler can properly be included in the pool because of the cost benefits that they arrive -- that they derive from larger production volumes.

Q. Okay. But you also have testified you do not know what -- the production risk a producer-handler has; right?

A. No, I have no specific knowledge about that.

Q. All right. So let's go back to your statement, let's ascribe a value, a variable, we won't put a number to it, but a value of when it becomes profitable at the production -- or the processing side, by your curve, because that's what your study did, okay, and let's say that that's A, and that's that level of profitability, but at -- you would also have to say that on the production side there's a risk value, right? There is some risk, you would agree, on the production side?

A. Yes.

Q. And you would also agree that in an integrated operation, that the risk of the farm and the risk of the plant intermix and it changes the overall risk picture as an entity, compared to their two separate ones; right?

A. I guess, as they say, not exactly, and I think I can shortcut this with a more complete answer to Mr. Tosi's question, and I think I was expecting to walk off the stand here and be finished, and that caused me to be shorter than I should.

What was going through my mind as I answered his question was my general knowledge of the cost to produce, and as I think I testified earlier this afternoon: smaller producer, higher cost; larger producer, lower cost. And at hearings like this and at hearings in Pennsylvania and at the dairy forum earlier this week there was discussion about the cost to produce milk, and as a producer-handler gets larger, meaning more cows, intuitively, I assume, that the industry statistics, that we've all seen, goes down.

So that's part of that risk: smaller number of cows, higher risk; larger number of cows, lower risk, and the risk is determined by how your cost to produce compares with one statistic, the blend price, in a market.

So that's what was going through my mind as I answered Mr. Tosi's question.

Q. But you have not identified the value of the risk of a producer-handler at the production side; is that right?

A. I have not identified it nor quantified it specifically.

Q. Right. So that you may, at a plant side, if it was just a plant, that at 3 million, that there's a break that starts to work your way, but if you add the risk at the producer side, it may have to break at a higher rate to offset the higher risk from the production side; right?

A. I haven't studied that.

Q. You haven't studied it. So the question, then, is: You cannot tell this Secretary, and in this hearing, that on a producer-handler, with production and processing, that you have studied and identified the fact that at 3 million pounds a producer-handler can be profitable and compete with a processor, have you?

A. No, I believe they can be.

Q. Have you studied that?

A. I believe they can be --

Q. Have you studied that?

THE COURT: If you can calm down.

MR. YALE: I'm sorry.

THE COURT: And if you could answer the question that he's asking you, we can probably get out of here today.

A. It's my opinion, based on the studies that I've done and the testimony that I've given, that the 3-million-pound cut-off is the right cut-off, at which time they can be competitive.

BY MR. YALE:

Q. Without understanding the production value, right? Without quantifying it.

A. Without making a specific study of the production costs but having an opinion based upon, what I've just said, I've just testified to, as to the cost to produce and the relationship between size and cost at the farm.

Q. All right, let's talk about risk on size. We're unfortunately going through a very difficult time on the farm level, and in the Pacific Northwest you're aware of the BSE?

A. Yes.

Q. Okay. You're aware of the bovine tuberculosis issue that's starting to crop up in Arizona and Texas?

A. Yes.

Q. All right. And what's the response that happens at those operations, do you know what happens, when they discover those diseases?

A. Yes, I do.

Q. And what is that?

MR. BESHORE: Your Honor, may I inquire into the relevance? Now, if we're going to get into BSE and bovine tuberculosis, I think we're out of bounds.

THE COURT: Why don't you tell me where we're going with this.

MR. YALE: I'll tell you exactly the -- Mr. Tosi asked this witness whether he was saying that that 3 million covered the mix of the risk of production.

THE COURT: Okay, but didn't you get your answer to that question --

MR. YALE: No, I didn't, because he has said that in his opinion, that as you rise and become bigger, that that risk goes down, and I'm identifying a major area where, as you get bigger, the risk increases, and that's what I want to go with.

THE COURT: Okay, I'll let you go there, just --

THE WITNESS: Your Honor?

THE COURT: I'm not sure how relevant it is, but I just want to -- you know, I just want to --

MR. BERDE: Your Honor, I object to the mischaracterization of what I recall Mr. Tosi asking the witness about. He asked, if I recall, about why we regulate above 150,000 and why between 150,000 there should not be regulation, up to -- between 150,000 and 3 million there should not be regulation. That's what the correction of Mr. Tosi's questions were about.

THE COURT: Yeah, but I think implicit --

MR. BERDE: He didn't get into the producer end of the business whatsoever.

MR. YALE: We can let the reflect on that.

VOICE: Could we have a 1-minute break?

THE COURT: Well, I'm either going to call a 1-minute break or I'm going to -- I mean if we're going to break, I'd just as soon -- assuming that Mr. Ricciardi is going to be available with his witness -- why don't we just take our 15-minute break now and then we're going to charge on through, with any luck, after that. So it's about 11 or 12 minutes after; let's come back just before 3:30, okay, and then hopefully we can go through with this, all the way through. Off the record.

(Off the record and reconvened.)

THE COURT: On the record. Mr. Yale?

MR. YALE: Your Honor, I have no more questions at this time.

THE COURT: Thank you, Mr. Yale. Does anyone else have questions of this witness?

MR. BERDE: I do, but we're waiting for Mr. Tosi.

THE COURT: You need Mr. Tosi to be here for you to ask your questions?

MR. BERDE: Well, it relates to a question --

THE COURT: Here he comes.

(Pause.)

THE COURT: Go ahead, Mr. Berde.

REDIRECT EXAMINATION

BY MR. BERDE:

Q. Following up on Mr. Tosi's questions, and I have a couple more, by Mr. Yale:

With respect to a producer-handler below 3 million, is it fair to say that your conclusion that their costs of operation are such as to not constitute a significant enough impact, competitive impact, in the market as to warrant a regulation?

A. That's -- yes, that's one of the -- one of the opinions.

Q. And are you aware that the original justification of the Secretary, going way back, in exempting producer-handlers was the conclusion by the Secretary that producer-handlers constituted an insufficient competitive impact in the market as to warrant regulation?

A. Yes, I did read that statement in doing research and preparation for this engagement.

Q. And essentially that's the rationale for today, by the proponents, choosing that 3 million as the hard cap, below which we permit the continuation of producer-handler exemption and over which we propose their regulation.

A. Yes.

MR. BERDE: Thank you.

THE COURT: Are there any further questions of this witness?

(No response.)

THE COURT: Mr. Herbein, thank you very much. You may step down.

(Witness excused.)

THE COURT: Okay, Mr. Ricciardi, are you ready to -- my understanding is that Mr. Ricciardi is going to call his witness now, Mr. Swanson?

MR. RICCIARDI: Yes.

THE COURT: Mr. Ricciardi, call your next witness, please.

MR. RICCIARDI: Al Ricciardi, on behalf of Sarah Farms. Thank you, Your Honor. The next witness that we will call is Tom Swanson.

THE COURT: Okay. Mr. Swanson, have a seat, raise your right hand.

THOMAS SWANSON, OPPONENT'S WITNESS, SWORN

THE COURT: Can you please state and spell your name for the record, Mr. Swanson.

THE WITNESS: Thomas Edward Swanson, S-w-a-n-s-o-n.

DIRECT EXAMINATION

BY MR. RICCIARDI:

Q. Tom, thanks for taking the time to come here to