UNITED STATES DEPARTMENT OF AGRICULTURE

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In the Matter of:  *
                   * Docket Numbers:
NORTHEAST MILK     *   AO-14-A70 et al;
MARKETING ORDER    *   DA-02-01
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Thursday,
September 12, 2002

Embassy Suites Hotel
1900 Diagonal Road
Virginia Room
Alexandria, VA

The above-entitled matter came on for hearing, pursuant to notice at 8:00 a.m.

BEFORE: DOROTHEA BAKER,
Administrative Law Judge

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I N D E X

E X H I B I T S

NUMBER:	IDENTIFIED	RECEIVED
Exhibit 16		681
Exhibit 17		681
Exhibit 18	682	823
Exhibit 19	682	823
Exhibit 20	824	844
Exhibit 21	848	939
Exhibit 22	848	939
Exhibit 23	848	939
Exhibit 24	940	990
Exhibit 25	941	990
Exhibit 26	941	990
Exhibit 27	998	1015
Exhibit 28	1016	1024
Exhibit 29	1025	1027
Exhibit 30	1059	1061

M O R N I N G   S E S S I O N

JUDGE BAKER: This is the third day of our hearing relevant to Proposed Amendments to Milk in the Northeast Marketing area. It is a public hearing in which all interested parties have the opportunity to participate, to present evidence or testimony, and their participation is invited and is encouraged.

Mr. Beshore, when we adjourned last night, I believe that questioning had been concluded with respect to Mr. Shad.

MR. BESHORE: It had, Your Honor. I would like to move the admission of Exhibit 16 and 17, if we haven’t done that. Mr. Shad’s testimony and exhibits.

JUDGE BAKER: Very well. Are there any questions or objections with respect thereto? Let the record reflect there is no response. Exhibit 16 and 17 are hereby admitted and received into evidence.

(The documents referred to, having been previously marked as Exhibit 16 and 17 were received in evidence.)

MR. BESHORE: I would like to ask that the documents which have been distributed in the room and to the court reporter, the testimony of Ed Gallagher on Proposal 7, Part 2, be marked as Exhibit 18 and the exhibit set to, relating to Proposal 7 submitted **by** Edward Gallagher be marked as proposed Exhibit 19. Mr. Gallagher has resumed the stand. He has previously been sworn and he is prepared to proceed with his additional testimony, Your Honor.

JUDGE BAKER: Very well. Thank you. The documents you mentioned shall be so marked.

MR. BESHORE: Thank you.

JUDGE BAKER: You are welcome.

(The documents referred to were marked for identification as Exhibit 18 and 19.)

MR. BESHORE: You may proceed, Mr. Gallagher with your testimony in further support of Proposal 7.

TESTIMONY OF EDWARD GALLAGHER:

MR. GALLAGHER: Okay. Thank you.

Good morning everybody. Thank you for allowing me to return to testify further about the ~~ADC&E~~ **ADCNE** Marketwide Service Proposal.

MR. BESHORE: Actually, if I might, if I might interrupt you, why don't you just preliminarily go through the exhibits.

MR. GALLAGHER: Okay.

MR. BESHORE: Which are Exhibit 19, briefly, identify them as you will be referring to them during your testimony.

MR. GALLAGHER: Okay. Figure 1 is a chart that I put together based on the milk intake at the Dietrich's Plant in Reading, Pennsylvania, that identifies the monthly volume in January 2000 through June 2002. And the line that goes across that is just above 50 million pounds is the maximum amount of milk they used, they brought into the plant during that time. And it sort of characterizes their, not only their intake, but what they didn't receive, so that what they weren't receiving relative to their maximum capacity.

The second chart is a similar chart, but it is for the Dietrich's Plant at Middlebury Center, Pennsylvania.

Figure 3 is a comparison of the intake at the Reading Plant by month to the intake by month that would have been converted from Charlie Ling's, Dr. Ling's study. And it is a comparison of the intake in that study to Reading.

The Figure 4 is the same comparison for Middlebury Center.

Table 1 is an example that I will be explaining further in my testimony and it identifies a balancing cost relative to lost zones and hauling charges when you are moving milk from a Class I plant and diverting it for balancing to a manufacturing plant.

Table 2 lists the actual intake pounds of both the Reading and the Middlebury Center plants from January 2000 to June 2002. And it is from this table that I based the previous figures on, that identify the two plants intakes and relative comparisons.

Table 3 is as ugly as it gets. It shows DMS' balancing costs for the last 19 months.

And Table 4 is just an overview of the categories that go into the income statement, determining the lack of profitability at the Dietrich's plants.

MR. BESHORE: Okay. Thank you. Now, I interrupted you, and you may resume.

MR. GALLAGHER: Okay. A Brief History of Dairylea.

Dairylea Cooperative's business operations can best be described as in a continuous process of evolution. Today's Dairylea is vastly different than it was 50 years ago or even five years ago. It started in the early 1900's, it quickly became one of the largest dairy cooperatives in the Northeast, and in so doing, was involved in just about every milk processing and manufacturing operation known, at the time. Its members invested in, and management operated, hundreds of manufacturing, processing and county receiving stations throughout the Northeast.

Over time Dairylea's results with operating plants were not good. In the early 1980s, Dairylea's members and management made the decision to exit from the management of operating plants. By the mid 1980s, Dairylea accomplished this and set out on a new strategy of providing marketing, membership and on-farm services to its members. The history of Dairy Farmers of America predecessor cooperatives in the Northeast, including Sheffield Farms, and Eastern Milk Producers Cooperative, would be found to be very similar to Dairylea's.

The services oriented strategy has served Dairylea's members, customers, and in general, the Northeastern dairy industry well. Since 1990, Dairylea grew from marketing one billion pounds of milk annually, to its present size of marketing more than five billion pounds annually from more than 2400 dairy farmers members who I represent today. A strong proportion of this growth occurred by Dairylea's ability to get medium sized dairy cooperatives to join Dairylea as member cooperatives. This allowed those cooperatives to enjoy the milk marketing and member service benefits of a large cooperative, and at the same time keep their culture, local presence and private governance.

Today~~'s~~ **Today** Hoard's Dairymen ranks Dairylea the fifth largest dairy cooperative in the United States.

The DFA Joint Venture and Dairy Marketing Services.

In 1999 Dairylea's business evolved further when it entered into a joint milk marketing and membership venture with Dairy Farmers of America and formed Dairy Marketing Services. Dairy Marketing Services, headquartered in Syracuse, New York, is responsible for the milk marketing and membership operations for Dairylea in the Northeast Council of Dairy Farmers of America. Referring to Footnote 1, the Northeast Area Council of DFA encompasses the ~~geographical~~ **geographic** territory that includes New England, New York, New Jersey, the territory in Pennsylvania east of the Allegheny Mountains, Maryland and Delaware. This region was the membership territory of the former Eastern Milk Producers Cooperative. In the early 1990s, Eastern merged into Milk Marketing, Inc. In the late 1990s, Milk Marketing, Inc. was one of the founding cooperatives of Dairy Farmers of America.

Through the Dairylea and DFA relationship, DMS markets over 12 billion pounds of milk annually.

Although the Dairylea and DFA members and member cooperatives make up the majority of the milk DMS markets, it has also forged marketing relationships with other cooperatives and independent handlers. In the case of the independent handlers, the milk marketing and payroll functions have been, or are in the process of being outsourced to DMS and/or DFA, who will provide these services to the particular independent dairy farmers.

DMS markets, on average, 650 loads of milk a day, to more than 100 milk plant locations for over 7,000 dairy farmers. A significant number of these plants package fluid milk for route delivery. DMS sells more milk to Class I distributing plants in the Northeast than any other business.

The DMS marketing scope and depth cuts across every region of the Northeastern U.S. -- the only such milk marketing business in the region that does so. It supplies Class I plants in Maine, and manufacturing facilities in western New York. It delivers milk to Class I facilities serving Boston, Connecticut, New York City, Northern New Jersey, Philadelphia, and Harrisburg, Baltimore and Washington, D.C. It also serves Class I customers with sales in Scranton, Binghamton, Rochester, Syracuse, Utica, Albany, Springfield, Massachusetts and points in-between. Additionally, DMS supplies manufacturing plants from northern Vermont, New York, south to Maryland and from Central Massachusetts, west to northeastern Ohio.

The DMS Milk Balancing Operations.

For its size and scope, DMS balances its milk differently than most cooperative organizations in the country.   Where many cooperatives rely on cooperative owned balancing plants to be the primary process of balancing milk supplies, DMS does not do so necessarily. Instead, DMS employs a strategy of balancing milk at the region’s manufacturing plants, most of which are not owned or operated by DMS, Dairylea or DFA. In fact, DMS has no ownership interest in plants, while Dairylea has minimal interest. DFA has more substantial balancing plant ownership, commercial interest ~~in~~ **than** Dairylea.

Dairylea is one of the three cooperative owners of O-AT-KA Cooperative, the butter/powder and speciality products plant located in the western New York town of Batavia. DFA is the owner of two powder and speciality products facilities under the name of Dietrich’s Milk Products, LLC. Referring to Footnote 2. Until just recently, Dietrich’s Milk Products, LLC was equally and jointly owned by DFA, Dairylea and the Dietrich family. This three way ownership began in 1999. Although Dairylea is no longer an owner in Dietrich’s, the balancing cost associated with these plants are still shared between Dairylea and DFA. In essence, DFA owns and operates the plants on behalf of DMS. DMS is charged ~~Dietrich~~ **Dietrich's** balancing costs. In turn, via the proprietary formula, DFA passes those costs along to its owners and to the members of Dairylea and DFA's Northeast Area Council.

MR. BESHORE: Mr. Gallagher, did you mean that DMS passes those cost along?

MR. GALLAGHER: Yes.

MR. BESHORE: Okay.

MR. GALLAGHER: One plant is located in the southeastern Pennsylvania city of Reading, while the other is located in the northern tier of Pennsylvania in a town called Middlebury Center. Although DFA owns a large cheese plant in western Pennsylvania, Farmers Cheese, the proximity of it to the east coast's metropolis and its important Class I **processing** business, makes it of limited use to balancing the DMS and Order 1 market's daily and weekly Class I and overall producer needs. However, it is utilized as one of the number of plants to help balance seasonal and holiday surpluses.

The Portfolio Balancing Strategy.

DMS follows a ~~balancing~~ strategy developed previously by its member owners, Dairylea and DFA and DFA's predecessor organizations here in the Northeast. This strategy uses a portfolio approach to balancing member and customer milk needs. The portfolio is made up of every manufacturing ~~customers~~ **customer** in the Northeast including the three plants, fully or jointly owned by DFA or Dairylea. The portfolio approach reduces members' risks by:

Limiting their investments in the cooperatives, allowing their members to have a greater share of their farm's equity available to them as they wish,

Attempting to optimize the use of existing plant capacity,

Supporting the business operations of the region's manufacturing plants owned by others, providing ~~the~~ **such** operations additional volumes of milk to help them grow their businesses and reduce their operating risks and above all,

Mitigating the cost of balancing the milk, **to** the region's milk supplies.

Renting Balancing Space.

In its simplest form, there is a "facilities" cost of balancing. Many cooperative's balancing costs come to the process of owning facilities. These costs are incurred either through the cost of operating plants or through the cost of carrying the plant ~~asset~~ **assets** in the fall months and at other times the year when the plant is significantly underutilized or idle. When using other business facilities to balance, this cost, in one form or another, can be boiled down to the market costs of renting balancing space. The DMS portfolio approach relies both on "rented" space as well as owned space.

Others **have** ~~testifying~~ **testified** on behalf on ADCNE, or excuse me, ADCNE and spent more time discussing the costs of owning balancing space. I want to spend a little time discussing the cost of renting balancing space.

My use of the term "renting" balancing space is an economic term. There is no actual process that I am aware of that involves a rental agreement or lease to avail at a cooperative of space at a manufacturing plant to balance their members and customer milk needs. However, there are "real" costs that do exist. Those real costs, are in a sense, rental payments for plant space.

Rental Balancing Costs Under Class Pricing.

The following identifies a real world cost of renting balancing space by using a more commonly referred to term: under class pricing. To help illustrate this cost, take, for example a load of milk that is delivered to a pool distributing plant on an every **other** day basis (recognizing that most producers are picked up every other day) with the exception of the weekend when the Class I processor is limiting its intake of milk.

As was described in earlier testimony, DMS is a co-operator of the milk grid and, in doing so, assures that all milk produced finds a plant demand point, even if the normal plant demand point, in this example, the Class I processor, chooses to reduce its purchases. As part of this service, DMS finds a manufacturing plant willing to take the load not needed by the distributing plant.

The economic return on this particular load is different than on milk delivered to the manufacturing plant on a regular basis. Here is why. Manufacturing customers contract with DMS for a given amount of milk per week, month or year. A price is set for these regular deliveries that is based on Class price plus handling charges. The ~~price is set~~ **pricing** on regular deliveries, which are loads of milk that land at the manufacturing plant consistently throughout the year, is determined in advance of the milk being produced and is based on "general existing" marketing conditions. Generally existing marketing conditions can be described as milk being long in the flush and short in the fall, but that the market for the year is not excessively long or excessively short. The Class plus handling charge price holds throughout the year, unless an excessive milk condition occurs. Referring to Footnote 3. Under excessive milk conditions, regular loads are still priced at Class, but the handling charges adjusted to reflect the excessive condition - meaning higher handling charges when milk is excessively short, and vice ~~versus~~ **versa**. When a balancing load becomes available, such load generally falls outside of the contract's pricing. In such a case, the load is priced on **the** "spot" market, determined by that particular day's supply and demand dynamics.

These loads also carry another demand ~~characteristics~~ **characteristic** that underminds the load's value. I call this for lack of an appropriate economic term "opportunistic" pricing. Let me explain.

When a manufacturer is offered a load of milk being balanced back from a Class I source, the manufacturing operator knows, based on the interactions of the dispatching and receiving processes, that the milk is normally delivered to Class I, isn't needed by Class I and is in search of a delivery location. When this milk is offered to the manufacturer, the plant operator knows he can buy the milk at a discount to its normal class plus handling price. The manufacturing plant knows this since DMS has to land that load quickly because the milk's perishability, its inability to be inventoried on a truck and the need for the truck and trailer to be ready to meet its demanding schedule of picking up its next load on the farms. Generally, no matter if milk is excessively long or really short, balancing loads do not return the same price to the cooperatives as do regular deliveries. And, during the flush and other times, these loads generally are priced at Class price minus.

If the weekend load was delivered to the manufacturing plant during the flush season, it would likely be priced at a discount to the Class price is likely where the spot market - that day’s supply and demand interaction - would be that determines the “clearing” price for milk. Since DMS settles with the Order at the value of a Class price and the producers get paid the “blend” plus premiums - as dictated by competitive market dynamics. The under Class price discount is a real business cost involved in balancing milk supplies.

This type of cost would not be associated with just the weekend balancing loads. These dynamics and their associated costs have the potential to be involved with the balancing of all necessary milk supplies, as defined by Dr. Ling - especially during the flush and around holidays.

The same costs is generally ~~include~~ **incurred** when milk is “turned back” during the week. A “turned back” load refers to a load that is ordered by a Class I customer at the beginning of the week based on that customers anticipated milk processing needs for the week. As the week goes by, the processor recognizes it has over ordered because its supermarket customers orders aren't as brisk or it is receiving more milk than it anticipated by its independent producers or cooperative supplies. When this occurs, the Class I customer notifies DMS that it is cutting back orders, and in effect, has DMS balance its Class I needs as opposed to asking its own independent shippers to balance its needs. Economics on the delivery of this milk, relative to the underclass pricing rental balancing cost, is quite the same as that explained in previous scenario. Referring to Footnote 4. From time to time and when some Class I customers, a turn back fee can charged in these instances, although it is very infrequent. However, the ability to utilize turned back fees is very limited to certain customer situations, only applies to milk loads ordered and then canceled during the week, and during the flush, the turn back fees generally only mitigate a portion of the balancing costs on a turned back load.

Rental Balancing Costs Loss Handling.

Another rental price is the cost of loss handling and balancing loads. In many cases, the weekend balancing milk carries a reduced or, in some cases, no handling charge for the sale. Again, this is for the same reasons described in the under Class pricing discussion about spot milk and opportunity pricing. Since the producers will still be paid premiums for the milk on the load, regardless of whether or not it is balancing milk, the cost of foregone handling to cover the premiums paid to the producers becomes a real business cost. Although I do not know the count, more loads of milk ~~that~~ are sold at reduced or no handling costs than at under class pricing. All loads sold in the class are sold at zero handling.

Under class pricing and loss handling charges are balancing costs associated with maintaining the necessary reserve supply of milk to meet our Class I customers fluctuating, daily, weekly, seasonal and holiday demands. For instance, an every other day pickup route that is delivered to a Class I processor once or twice during the fall, but isn't needed by the Class I processor in the spring flush, can't gain the same economic return at manufacturing plants as it can at Class I plants. Since the route isn't available to the manufacturing customer on a regular basis, the manufacturing customer who has made other plans to meet its milk supply needs isn't willing to pay as much for the milk that only sometimes shows up at the plant. Referring to Footnote 5. In fairness to our manufacturing customers, they can't afford to pay the full price for this milk. These customers have already made plans to sell their production from their regular deliveries. Generally, their customers do not need any more products so aren't necessarily willing to buy additional product unless there is a clear price discount available. Likely, these manufacturing plants would not purchase the milk if they didn't have a sale because of the high risks and cost of inventorying and hoping to develop a sale. Therefore, these manufacturing customers are only willing to purchase additional product if the price is discounted enough to help the manufacturer move the product to one of their customers relatively quickly.

Certainly one can see the different economic positions, a balancing load of milk is under, not only on weekends, but at other times as well. For instance, an unfavorable economic position ~~occurred~~ **occurs** when balancing seasonal surplus during the flush, when schools are in session, on holidays or the week leading up to Christmas or New Year's Day.

Diverting from my written testimony for a moment. There is another rental balancing cost that I didn't think of when I was bringing this together and I am glad Mr. Miller of Queensboro Farms and the vice president of New York State Dairy Foods, who sound like he was testifying in favor of marketwide services, referred to another rental cost and that is cost incurred with -- ~~towing~~ **tolling** I think referring to Mr. Miller's testimony, he mentioned that ~~towing~~ **tolling** does occur. The DMS uses other plants from time to time to ~~tow~~ **toll** milk. They will ~~tow~~ **toll** because they do not want to have to take any responsibility of trying to sell the product from that milk, and yet have space available at their plants to manufacture and are willing to "rent it to us", for a price. And Mr. Miller identified that that rental price at his plant was in ~~essence~~ **excess** of a $1.00 a hundred weight. And so automatically, we are at least that much below the class price when we do a ~~towing~~ **tolling** arrangement. And there is a significant cost in our operation.

Back to my testimony, written testimony.

Balancing Cost, ~~Unreimburse~~ **Unreimbursed** Delivery Cost.

Not all balancing cost are incurred when renting space or operating plants. A particular cost incurred by those co-operating the milk balancing grid is common to all, whether they are renting space or operating plants. This particular real world balancing cost occurs when there are unreimbursed delivery costs associated with diverting milk to a manufacturing plant from its usual home at a distributing plant.

Dairylea and DFA member pay programs have evolved, have evolved into something more like farm point pricing than plant point pricing. This ~~is~~ **has** occurred due to our reactions to the market place as opposed to a strategy to set us apart from the market place. Written another way, competitive market dynamics have dictated this pricing mechanism. By farm point pricing, I mean, that a member more often than not, is assigned ~~to~~ **a** producer price differential zone for his or her area based on local manufacturing plant, regardless of whether the member's milk is delivered 240 or so miles to a distributing plant or 30 miles to a manufacturing plant. Similarly, the hauling charge to members is designed to cover the cost of delivering milk locally, plus **costs** corresponding to the zone of the producer's price differential and meeting the competitive dynamics in that particular producer's region.

For most deliveries of milk from, say Central New York and Northern Pennsylvania in towards the cities, the higher city zones, generally, cover most of the additional costs of moving the milk from up country to the Eastern Seaboard cities. This generally occurs even though the zone differences between manufacturing areas and the major Class I consumption areas were narrowed during Federal Order Reform. Producers that deliver to a distributing plant a majority of the time, if they are under a local paid price program, generally have any portion of the hauling cost, not covered by zone, added to their hauling charge that shows up on their milk check. Generally this is the case if the local procurement area's supply and demand situation allows these costs to be passed along. This is not always the case. Especially in areas where ~~propriety~~ **proprietary** Class I plants, with their own producer supplies are actively soliciting milk.

In general, the economic delivering of milk for the Class I market, on a regular basis, from normal supply areas, say 240 miles and into the Metro New York area, and Boston, result in the milk landing in, say Northern New Jersey, with no or little other extra cost to the dairy cooperative. This means that the "net" of the producer price differential paid to the cooperative and the handling cost that it bears for delivering the milk to the distributing plant, match the producer price differential paid to the producers ~~in~~ **and** the hauling charges they are assessed.

There is a significant daily and weekly variation in raw milk demand at distributing plants, as explained by Bob Wellington and alluded to in my previous testimony, and shown by our exhibit yesterday that Dennis Shad presented. Although loads of milk, made up of the milk production of a number of Dairylea and DFA farms, may be delivered to a distributing plant a majority of the time, it is very rare that these loads be delivered to a distributing plant all the time. Referring to Footnote 6. This is unlike individual producers or small cooperative ~~procured~~ **producers** by priority Class I distributing plant. For these producers, their milk is delivered to the Class I plant every single day with very few exceptions.

Referring to dairy farmers, the dairy shipper that testified yesterday indicated that for the last 17 years, 365 days a year, his milk goes to their Class I bottling facility in Syracuse, New York.

When this milk isn't delivered to the eastern seaboard distributing plant, but instead is delivered to a manufacturing plant, the net zones and hauls for the manufacturing plant delivery do not always net to zero.

This means that the producer price differential received for the load, and the hauling cost ~~of the~~ **for** delivering the load do not match the producer price differential paid to the producer or the hauling charge extracted from the producer. When this doesn't net to zero, it results in a cost to be borne by the cooperative.

Footnote 7. It is the very rarely based on the results when the net results and gain to the cooperative.

Thus, another real balancing cost is incurred when milk is diverted from its regular distributing plant estimation and the economics of the plant zone and hauling charge of the plant receiving the diversion do not net the same value as the normal distributing plant delivery.

These costs are even greater when the balancing plant was in a lower zone than that which the producer is paid. For example, during the spring flush, it is not uncommon to move milk, usually ~~diverting~~ **diverted** to distributing plants in Metro New York to O-AT-KA. The producer paid program would be set up so that on the deliveries to New York City the net producer price differentials and hauling charges collected and paid are zero. Thus, the economic analysis of any net impact to a cooperative that balances its milk would be a straight up comparison between zones and hauling charges for the two alternative ~~designations~~ **destinations**.

Exhibit 19, Table 1 depicts the economics of a real world balancing milk movement. It shows that the ~~zones~~ **zone** for the Dean Foods plant known as Tuscan Farms in Union, New Jersey is Boston (the zero zone) minus $0.10 cents, and the zone at O-AT-KA is Boston minus a $1.05.

When this balancing movement occurs, the cooperative is out ninety five cents in zone. Since the distance between Central New York (for example the Cayuga County town of Locke, New York) and O-AT-KA is less than the distance between Central New York and Tuscan Farms, the O-AT-KA delivery’s hauling cost is less. For the Tuscan delivery, the hauling charge is about $1.19 per hundred weight and for the ~~O-TA-KA~~ **O-AT-KA** delivery, the hauling charge is seventy-five cents per hundred weight. This results in a 44 cent per hundred weight hauling savings to the cooperative. Unfortunately, the savings and hauling costs do not match the loss of income in zones. Thus, the cooperative registers a real world balancing cost of 51 cents per hundred weight on this movement. This cost is on top of any loss handling and under class pricing that also may be incurred.

Balancing Costs Include Balancing “In”.

Balancing the ~~market~~ **market's** need isn’t just handling Class I’s operation reserves, milk that is turned back from Class I or seasonally long, it is also providing milk to Class I in the fall or ~~at~~ **any** other ~~time~~ **times** when the milk supply is tighter. Upon review of Dairylea Federal Order Reform comments, you will be reminded that Dairylea was a proponent of narrowing of the zone differences ~~in~~ **and** flattening them in western and northern New York. This was requested, in part, to prevent further erosion of blend prices for the sole purposes of assuring that the higher hauling costs of ~~supplement~~ **supplemental** milk from distance manufacturing areas would move milk to Class I on the few occasions it was needed. It was also requested as a means of mitigating the balancing costs described in the previous section, referring to Section 8, excuse me, Footnote 8. As a previous discussion illustrated, such costs are far from mitigated with their flatter pricing.

Instead ~~the~~ Dairylea pointed out, it would be better to maintain stronger blend prices by having ~~flatten~~ **flatter** zones in the outer areas of the milk shed where the Northeast milk production sector is growing and becoming more and more relied upon to fill the needs of the Federal Order Class I market. Referring to Footnote 9. Although not shown, a review of production trends in the Northeast would show production declining in the traditional Class I procurement areas of Massachusetts, Connecticut, Central New York and Northern Pennsylvania. Alternatively, production is growing in Northern and Western New York. Going forward, milk produced in Northern and Western New York will take on increasing strategic importance in assuring that the Class I plants, serving the Eastern Seaboard cities, will be adequately supplied with milk.

Most of the milk in these outer areas is marketed by cooperatives. This milk, milk that isn't marketed by cooperatives is controlled by proprietary plants that operate manufacturing plants.

Unfortunately, the market dynamics, the market's competitive dynamics and the differences in zones between Western and Northern New York and the Class I plants along the Eastern Seaboard, do not allow for these costs to be recouped. Although, the Secretary agreed with the suggestion of flatter zones, another element of the request, to have a marketwide services balancing payment program to compensate the cooperative for their extra costs of moving milk from areas of supplemental supply to the Class I market, was not included.

Since Federal Order Reform, the dairy cooperative members of DMS have taken on additional contractual obligations for supplying certain Class I customers with 100 percent of their milk needs. The Northeast market's competitive dynamics, discussed at this hearing, make it prohibitive ~~to~~ **for** DMS to extract higher handling charges from these customers in order to cover these extra costs.

Again, Dairylea requests the inclusion of the proposed marketwide service program to compensate the dairy farmer members of Dairylea and DFA, as well as the other ADCNE members, for fulfilling the important functions they provide the Class I market and all Order Number 1 producers in their work to assure our Class I customers receive the milk they need, when they need it. Doing this maximizes the milk pooled in Class I and generates stronger producer price differentials for all producers.

Balancing at Dietrich’s.

Like the other members of ADCNE, DMS also balances milk through plants owned by one or both of the member-partners. As previously stated, Dietrich’s Milk Products, LLC operates two pool manufacturing plants in Pennsylvania. One is in Reading and the other is in Middlebury Center.

The costs of operating these plants, and the associated balancing costs, have fallen back to Dairylea and ~~DFA~~ **DFA's** Northeast Area Council via a charge by Dietrich’s to Dairy Marketing Services and Dairy Marketing Services then passes those costs back to the individual cooperative owners of DMS.

The plants primary purposes are to balance the Class I needs of DMS customers and the Northeast milk market, in general. Both of these plants have been utilized as reserve balancing plants. Exhibit 19, Table 2 shows the monthly plant receipts of milk and skim condensed from January 2000 through June 2002.

The Reading plant is operated continuously over this time period. However, the amount of milk it had available to process is as variable as the milk price. Please note four aspects:

1) Reading processes more milk in the spring,

2) it receives significantly reduced volumes in the fall,

3) 2001 deliveries were low most of the year, and

4) it operates at less than full capacity most of the time.

Referring to Footnote 10. The maximum intake of milk during this period was 51.7 million pounds which occurred on two occasions. The plant's actual operating capacity is about 1.8 million pounds per day.

The operation of the Middlebury Center plant has been even more variable. In 2001, when milk production was tight, Middlebury did not take in any milk from August to November, and in six other months it received less than five million pounds.

Referring to Footnote 11. Middlebury's

operating capacity is about one million pounds per day.

Exhibit 19, Figures 1 and 2 are two graphs that show the plant capacity utilization at each of the Dietrich’s plants during this time period. The maximum capacity was determined based on the largest delivery to each plant in any month of the time period. These pictures graphically show the tremendous variability in milk receipts at these balancing plants.

There are significant costs of carrying an idle plant and operating plants at reduced capacity. During the 30 months shown, Middlebury operated at less than 50 percent capacity 16 months, more than 50 percent of the time, while Reading operated in such capacity during eight months, more than 25 percent of the time. Although Reading was able to operate during each month of 2001, it did not receive milk every day of the week. Its main purpose during the late summer and fall months was to balance the weekend, holiday and daily milk needs of the region’s Class I customers.

Although more milk is being delivered to these plants now, the flow of milk to them is not been constant. Again, more milk is delivered to them on weekends than during the weekdays. Thus, some of the costs related to idle plants, or operating the plants at less than full capacity, still exist even though the plants are taking on significantly larger volumes of milk each month, and that on weekends, at least during the flush, have been operating at maximum capacity.

The tremendous variability in milk receipts has created the obvious costs associated with idle and under used plant capacity. It has also impinged on the plants' ~~options~~ **option** of maximizing its revenue. Since the plant operators can't predict how much milk they will receive, or whether they will receive milk, it has become very difficult for them to win long term and steady contracts with users of milk powders. Kind of like how the U.S. is viewed in international markets, Dietrich's is viewed domestically. Because of the unique structure of the Northeast market and Dietrich's role in balancing the Class I market, powder buyers do not rely on Dietrich's as a steady dependable supplier of product. Therefore, the buyers go elsewhere, or like the "opportunistic" balancing cost I described earlier, the ~~buyer~~ **buyer's** know that Dietrich's sales force is caught between a rock and a hard place and therefore aren't willing to, and don't need to, pay as competitive of a price for Dietrich's powder.

The Dietrich's plants have been extremely unprofitable to operate, as a result. However, due to the region's expanding milk production and the limited manufacturing capacity near the metro New York and mid-

Atlantic area's Class I markets, the Dietrich's plants have been an integral and necessary part of the milk balancing grid. Closure of these plants, would have generated balancing costs in excess of the losses at Dietrich's. This result would have occurred since the existing plant capacity in the area would not have been able to absorb all of the milk that the Dietrich's plants would have shed. With the resulting market pricing through the flush and the added hauling costs, the total costs of balancing ~~the~~ milk at the region's other manufacturing plants and at plants in distant markets, would have exceeded the costs in operating these plants.

Exhibit 19, Table 3 depicts the DMS balancing costs for January-July 2002, by component, and for the entire year of 2001. To date for this calendar year, DMS has expended more than 9.1 million dollars balancing the Northeast's milk markets. This cost is net of any turn back fees and any cost involved with balancing milk pooled on the Southeast orders. This amounts to 20 cents per hundredweight on the Dairylea and DFA-Northeast Area Council's member milk supplies through July.

Footnote 12. On a full year's production, this will likely average about 12 cents per hundredweight to the members.

By component, DMS balancing costs include:

$4.9 million at Dietrich’s.

Referring to Footnote 13. Exhibit 19, Table 4 gives an overview of the income statement categories for the Dietrich’s plants. Costs associated with operating Dietrich’s are the only costs included. No costs associated with DMS, DFA, Dairylea or any other entity are included. DMS is charged a monthly crossover “recharge” that covers the losses Dietrich’s pays for milk, over and above what they can recoup from the market place given their operating profile.

Back to the testimony and the next bullet.

$0.6 million of underclass pricing

~~$0l7~~ **$0.7** million of unreimbursed hauling, and

$2.8 million in lost handling charges.

For 2001, a year of very short milk supplies, DMS incurred balancing costs in excess of 6.8 million dollars, includes note, there are two categories of costs, they didn’t bother calculating because it showed that we were at about 10 cents per hundredweight. That is quite a bit above the six cents we are asking from the pool.

And now back to the testimony.

Which was almost 10 per hundredweight on member milk supplies.

During the 2001 Christmas season, DMS balanced 17.1 million pounds which was (342 loads)of milk over two weeks at a cost of $520,000.00.

Dietrich's Cost vs. Ling Study.

Both Dietrich's plants are significantly below the plant capacity of three million pounds per day that is used in the Ling Study. Exhibit 19, Figures 3 and 4 graphically show the monthly plant intakes at Reading and Middlebury Center vs. that derived from the four butter-powder plants in the Ling study. For instance, Figure 3 shows that in May, the Ling plants averaged taking in about 90 million pounds of milk per plant while Reading took in slightly more than half that amount in 2002 and less than half that amount in 2000 and 2001. The Middlebury Center plant ~~Dietrich's~~ did not receive any milk in August-November of 2001. The plants in the Ling study always received milk equal to, at about half their capacity during the fall months.

Due to the significantly smaller nature of the Dietrich's plants, relative to the Ling study, and the more variable nature of the milk receipts at the Dietrich's plants, their costs are significantly higher than the those costs illustrated in the Ling study, intuitively.

Balancing Plants and Marketwide Services Eligibility.

Although both Dairylea and DFA have ownership interests in balancing operations, as do the other ADCNE members, the group advises against making non ownership of balancing facilities a prohibition for receiving marketwide service payments.

There are many ways and different business philosophies surrounding the process of being a co-operator of the Order Number 1 milk balancing grid. For many years prior to the DMS joint venture and the affiliation with Dietrich's Milk Products, Dairylea's primary process of balancing milk was via "renting space" from its manufacturing customers. This process worked in the heart of the DMS milk territory due to the significant abundance of proprietarily owned manufacturing plants throughout this region. Although Dietrich's plants have taken on a bigger role in balancing DMS' milk marketing network, "renting space" from our customer still serves as a major part of our milk balancing portfolio.

Dairylea and DFA are constantly analyzing opportunities to help our customers grow and to better invest the equity of our members. It is not unrealistic to think that at some point in the future, Dairylea and DFA, DMS or even another ADCNE member will no longer be involved in operating or owning manufacturing facilities. Yet, even though this would occur, each organization would still be providing the service of balancing member's and others milk by “renting space”.

A milk marketing business does not need to own a plant in order to balance milk. Additionally, ~~marketing~~ **making** plant ownership a requirement for receiving marketwide services could force dairy farmers into investing in and maintaining outdated, small and inefficient manufacturing facilities. Additionally, it could result in unneeded plant capacity in the Northeast - putting at risk the ability of the region’s current manufacturers to receive the milk supplies they need to grow their businesses in a manner that keeps them competitive with western U.S. manufacturing operations. Forcing excess plant capacity could also create issues for distributing plants and their efforts to assure an adequate supply of milk for the public.

The important aspect isn’t how milk is balanced; instead, it is how those that do the balancing can be compensated so that the farmers shipping to those co-operators of the milk grid aren’t disadvantaged by the service they pay to have performed.

Market Competition Prohibits Voluntary Balancing Charges.

Earlier in this proceeding I and others testified about the unique make up of the Northeast Order. Due to the Northeast’s huge population base, which represents almost one quarter of the U.S. population, it has been able to attract and sustain a rich, dynamic and diverse dairy industry. In so doing, it is the largest Federal Order in that it pools more Class I, II, IV milk than any Federal Order in the country. Additionally, it is the fourth largest Class III order in the country. These characteristics create a market structure that is unique and requires, and justifies, marketing order conditions that are as well unique in order to resolve disorderly marketing conditions.

Another aspect that I didn't talk about earlier when I testified two days ago was there is another unique condition and that is to the east of our region is the Atlantic Ocean and to the north of our region is another country, and so there isn't milk coming in from those directions. And that is fairly a unique situation relative to most markets in the United States, where there is only milk that comes in, either being produced in the region or come in from the west or from the south.

Of particular interest to ADCNE is the disorderly marketing condition that has essentially forced large dairy cooperatives to pay their members less than the minimum blend price due to their operation of the milk balancing grid that benefits all dairy farmers equally. Underlying this disorderly marketing condition, is the

Northeast's unique market make up that has created a plethora of milk marketing opportunities for dairy farmers as evidenced by the 78 dairy cooperatives and 32 proprietary milk businesses that, every single day, ~~competing~~ **compete** against one another in the milk procurement arena.

I state again, a disorderly marketing condition exists in the Federal Order Number 1 area right now. This exists ~~be~~ **because** cooperatives, via the financing of their members, operate the milk balancing grid and it is their members that shoulder the burden of carrying all the costs of providing this service. This occurs, even though the balancing service provided by the cooperatives results in benefits to all producers.

These benefits include:

higher producer price differentials as a result of maximizing the amount of milk delivered to Class I processors for use in the highest price classification,

greater stability in milk markets, since cooperatives provide the balancing cushion for Class I plant operators and thus eliminate the disorderly marketing condition that would result in its absence, that of Class I operators balancing their needs by dropping or adding producers as their seasonal needs changed,

supporting a stronger and more dynamic dairy industry by providing a stable flow **of milk** to the region’s milk plants thus reducing their risk of investment and providing all plants, either Class I or manufacturing, to thrive and grow and create steady and dependable markets for the regions’ dairy farmers, and,

support a system that creates an environment for stable and stronger voluntary milk premiums paid to all producers.

I know there is an interest in the quantification of this benefit and I would like to just use an analogy, because it is very difficult to come up with a ~~dollar~~ **dollars** per hundredweight quantification and I would like to use the analogy that I think it is undisputed that the military defense system of this country has significant value to every single one of us. I would challenge anyone of you in this room to quantify what that value is to you. And that is kind of like the challenge we have in quantifying that value that producers receive from the services we provide in balancing the markets.

Under current Federal Order market ~~provision~~ **provisions**, members of dairy cooperatives, who do the bulk of the balancing, are not receiving the same minimum Federal Order “blend” price as independent producers. Since these producers finance the cost of balancing the market and operating this grid, they, right off the bat, are placed in a worse position than those producers that do not ship to an organization that pools and balances milk. Since it is generally large dairy cooperatives that finance the milk balancing grid, it has placed their members in a secondary position to non cooperative producers in the market relative to sharing of Federal Order pools proceeds. This is unfair and our proposal recommends a solution that will help mitigate this inequity.

Conditions Exist for Emergency Action.

The balancing costs of the ADCNE members are significant and burdensome. They result in a disorderly marketing condition in that those that are responsible to assure that the Class I distributors have fluid milk available at all times, and that process doesn’t result in producers seasonally losing markets, are forced to pay their producers less than the blend price. This not only puts at risk the ability of those that operate the milk balancing grid to continue to perform that function. If the co-operators of that grid stopped performing the function, chaos would ensue. The proponent cooperatives and their members can not go through another flush period without having this inequitable situation corrected. ADCNE strongly urges Dairy Division to have an emergency decision implemented on our marketwide services proposal. Please note, the following from the Act of March 20, 1986, P.L. 99-260, Section 9 part b:

"(b) Implementation. Not later than 120 days after a hearing is conducted under subsection (a), the Secretary shall implement, in accordance with the Agricultural Agreement Act ... a marketwide service payment program under section 8c(5)(j) of such act .."

Again, thank you for allowing me the time to share this testimony with you today.

JUDGE BAKER: Thank you, Mr. Gallagher.

Mr. Beshore?

MR. BESHORE: Yes.

EXAMINATION BY MR. BESHORE:

Q Mr. Gallagher, one of the members of the ADCNE, which you referred to in your direct statement is O-AT-KA, could you tell us just a little bit more about what O-AT-KA is and its operations?

A Yep. O-AT-KA, O-AT-KA's membership is about a billion pounds of milk. Members are primarily located in

Western New York. They operate two Class I distributing plants. One is a --

Q Excuse me, Mr. Gallagher, are you talking about Upstate.

A I am sorry, Upstate.

Q Okay. Well, let's go ahead.

A Upstate is a billion pounds. They operate two Class I distributing plants in western New York. One is a ~~---~~ **pool** distributing plant, and one located in Rochester, New York. I believe they also own a Class II operation in Buffalo. And they are joint owners with Dairylea and Niagara Cooperative of O-AT-KA Milk Products which is a manufacturing plant. It is a balancing plant. It balances milk to butter, powder, and evap and they also have some speciality business at the plant. The plant's intake is about two million pounds of milk per day.

Q Okay. Let me go back and make sure the record is clear.

Upstate Farms Cooperative is a cooperative that is one of the members of the Association of Dairy Cooperatives in the Northeast, correct?

A Yes.

Q And that is the organization which you have indicated operates ~~to~~ **two** distributing plants which show up on the Market Administrator's information. And it is also one of the member owners of O-AT-KA Dairy Products Cooperative, which is also itself while a federated cooperative, it is a member of the Association of Dairy Cooperatives in the Northeast, correct?

A   Yes.

Q   Now, and Upstate, I think you indicated has markets about a billion pounds of milk annually for its dairy ~~farmers~~ **farmer** members.

A   Yes.

Q   And roughly what portion of that is in Order 1?

A   Forty to 50 percent.

Q   Okay. And O-AT-KA then is a federated cooperative, it is, which owns and operates a milk manufacturing plant at Batavia, New York, correct?

A   Yes.

Q   And the plant at Batavia is owned by Upstate, by Niagara Milk Producers Cooperative, a small cooperative in Western New York and by Dairylea, correct?

A   Yes.

Q   And the Batavia plant, I think the information in Exhibit 5 was one of the balancing plants for which aggregate receipts and usage information is reflected on page 85 of Exhibit 5.

A   Yes.

Q   Which Peter Fredericks presented, correct?

A Yes.

Q Is the O-AT-KA plant one of the plants which DMS uses in its system of balancing options?

A Yes, it is.

Q And it does, it ~~drives~~ **dries**, makes skim milk powder among other products.

A Yes, it does.

Q As you have indicated.

I would like to just refer you to, I don't know whether you have it with you or not, Exhibit 17, which was Mr. Shad's exhibit with respect to day of week delivery --

A I don't have it with me.

Q -- information. I am sure ~~you will ---~~ **you're familiar with it.** Okay. And it demonstrated the document that the, the demands from the ~~Agency and~~ **ADCNE** coops by distributing plants, in Order 1, on a day of the week basis and in the month of May 2001 and the month of November 2001, do you recall that?

A Yes, I do.

Q Okay. And do you recall that there is a swing of 10 million pounds per day from the low month, the low day in May to the high day in November, with 10 million plus --

A Yes.

Q -- pounds per month.

Okay. Is that in essence the, a, you know, one quantification of the balancing demands, that the market place is and which the ADCNE cooperative serve?

A It certainly is. It shows, you know, I think both Bob and Dennis referred to the operation of the milk balancing grid kind of like the operation of the electricity grid, where you have got demands spikes and that shows what the demand spike is and we have to carry the reserve to meet that demand spike.

Q Okay. And there, that, that 10 million ~~pounds~~ **pound swing** is, you are able to accommodate it by using every possible resource that you can, that you can assemble, and by you, I mean, DMS and the other cooperatives, serving the market in the Northeast, correct?

A Correct. We use, it is, every single manufacturing plant we, in the region, of any size, we incorporate into our balancing strategy. And so, we would, you know, if the milk is not going to a Class I, it is going somewhere and when Class I needs it, we take it away from manufacturing.

Q Okay. And if you are the responsible party for marketing that balancing ~~and~~ volume of milk, such as the cooperative is under contract with its members to market the milk, produced every day year round. If you are the responsible party for marketing that milk, that balancing volume, it is going to, you are going to incur cost and expenses in marketing that volume whether you actually ~~earned~~ **owned** the bricks and mortar ~~where~~ in the plant, where the milk ultimately is disposed of or whether you simply market the milk, correct?

A That is correct.

Q Okay. And that is what you have tried to describe with respect to DMS, which ultimately markets some of the milk to the DMA, DFA, Dietrich plants and much of its ~~balance and~~ **balancing** volumes to plants owned by other persons, correct, other companies?

A That is correct.

Q You have indicated that one of the, that you have called “renting space” that you have described, the use of facilities owned by others, as renting that space, correct? Is the ~~totaling~~ **tolling** fee of a dollar, in ~~essence~~ **excess** of a dollar a hundredweight, you know, one of the costs of renting --

A Yes, it is.

Q -- space of others. For balancing volumes.

A Yes.

Q Now, can DMS balance the Class I market for the costs quantified by Dr. Ling in his study, which isolated the balancing, Class I balancing costs, and used a low cost, most efficient butter, powder manufacturing system to balance the region?

A No, we can’t.

Q All right. So, that if the Secretary were to use the information related in Dr. ~~Ying’s~~ Ling's study, which isolates and quantifies on a conservative, most efficient model, if they would use those costs, to establish a marketwide service program, which resulted in DMS being reimbursed at the rate of six cents per hundredweight, it would cover only a portion, reimburse you for only a portion of the cost you incurred in balancing the market, correct?

A That is correct. It would mitigate our costs.

Q And it is the objective of the proponents of Proposal 7 by providing Dr. Ling’s study and the information that you have provided in terms of actual costs to demonstrate as best we can that this is an attempt to be conservative and reasonable in requesting partial reimbursement for some of these balancing costs, correct?

A That is correct.

Q Let me just talk about, ask you about the, one of the particulars of the proposal language, which Bob Wellington talked about yesterday. And that is the minimum size, a volume, there is no minimum size requirement to an organization to, that is the organizational structure, itself, number of employees or anything else, to get balancing services, correct?

A Correct.

Q You don't have to more than 300 employees to get reimbursed for balancing services under our proposal.

A That is correct.

Q Or 500 or 1,000 or anything else.

A That is correct.

Q Okay. But, we do require, the proposal suggests that the, the handler, cooperative or proprietary, that the handler have a certain scope of magnitude of operations in order to be subject to reimbursement for balancing costs, correct?

A That is correct.

Q Might that be described as, you know, something of a critical mass to have, you know, a balancing, performing a meaningful balancing function in the market?

A Sure.

Q In your experience, is there a qualitative difference between balancing, not just quantitative, but qualitative difference between the balancing that you need to do if you have got, you know, let's say, you know, at least a million pounds a day or three percent of the market versus a couple of hundred thousand pounds a day and, and, you know, one customer or a small number of customers?

A There is a significant difference. And if you think about just the size and scope of DMS, we market 600, 650 loads of milk a day, I bet, 300 plus on average go to a Class I distributing plant. It is, it is a significantly different operation. Now, there is ~~HB~~ **HP** farmers as an example, we ship about two and a half loads a day that maybe, if they ever have anything to balance, I don't know, but if they did, it would be load a weekend, on a bad day in the spring, far different strategy and challenge, not to balance one or two loads as opposed to hundreds of loads a day, or during the week. Certainly this, the effort that goes into, you know, if you have two or three loads that you have to balance, you can spend a lot of time needling over that and being creative and creating a, some, probably some creative solution to land three or four loads once or twice during a year. It is far different than when you are doing it every single week, and you have got to land hundreds of loads. You don't have enough man hours in the day to be creative, to do that. You have just got to get it done, so, the milk doesn't perish ~~or~~ **and** the truck is there for the next day's pickup.

~~MR. BESHORE:~~ In that regard, in size and scope and I think our proposal takes into account a certain size and scope that if you are of a certain size, that you probably are expending huge sums of money trying to balance the market on a regular basis.

MR. BESHORE: Thank you. Mr. Gallagher is available for cross examination.

JUDGE BAKER: Thank you, Mr. Beshore.

Yes, Mr. Rosenbaum?

MR. ROSENBAUM: Yes.

EXAMINATION BY MR. ROSENBAUM:

Q Mr. Gallagher, you ended your testimony on page 14 with a quotation from the Act of 1986. And in that quotation with -- what words is --

A You don't have it right in front of you.

Q It is your testimony.

A Marvin, can you help me out? Can you help me, so I can read it?

(Pause.)

MR. GALLAGHER: Generally, 7 USCS Section 601, Seq.

BY MR. ROSENBAUM:

Q I am sorry, the second parenthesis. The last

parenthesis, what words are you --
A [7 USC Section 608-C(5)(J)].
Q I am, sorry to interrupt, you don't see, you are quoting from Section B. I think you are now mixed up and quoting from A.
A No. No, this is a --
Q Keep going, please.
A All right. That meets the requirements of such Act.
Q Okay. Okay. So, that meets the requirements of such Act is what you left out?
A Yes.
Q Okay.
A I apologize for that, that is something that is really important, that we should have in there.
Q Well --
A And that is the legal --
Q Okay. Well, I mean, just to be clear, you have left out the fact that obviously the Secretary has to determine whether it meets the requirements of the Act, right?
A That is what I left out and that is your interpretation, ~~but~~ **let** you and Marvin ~~can~~ discuss that.
Q By the way, you are the third witness now, **of** proponents who have made the analogy to **being** like the

electricity **industry**, right?

A Yes, sir.

Q Let me ask you about that. When you talk about how something, electricity utility has to **have** capacity and meet demand, correct?

A Yes.

Q And sometimes that demand is less than capacity, correct?

A Yes.

Q Isn’t it true, for example, that just like some handlers don’t want milk at the same volume every day of the week, some electricity customers are willing to put up with having less electricity certain times of the day. And therefore, in a way that is different, time ~~--~~- **of use rates.**

A Sure.

Q And isn’t it also true that, for example, some customers don’t need or are willing to take the risk of not getting any electricity at all for certain periods of day, and their rate is changed on ~~the -- hard --~~- **what's called a hard interruptible rate.**

A Sure.

Q And so, the person who wants to have electricity all the time, pays a higher rate for his electricity than someone who is willing to only take the electricity some of the time, correct?

A Yes.

Q Indeed, there are variations on those things. There is something called "~~saw~~ **soft** interruptible rates" whereby someone who is willing to have electricity interrupted, potentially, if he rejects that request, he has to pay a higher rate, are you aware of that?

A I am not aware of that.

Q But, if, in fact, in the electricity industry, there are wide variety of ways in which particular customers, who have particular demands, ~~-- to that~~ **pay for that**, to a charge that you need to know.

A Yes. I am also aware in New York State when they set the electricity rates that the cost of unused capacity is built into the rate that people pay. I am not sure if it is built into every class, but it is built into the rate that they pay.

Q Well, sure, I mean, if someone needs the electricity all the time, they are going to pay a charge for that, but if they are willing to, to forego that, they get a break on their electricity rates.

A I don't know if in that break, there still could be some charge for unused capacity --

Q The whole concept is to try to match what an individual person is paying to what, what, what -- to speak on capacity that individual person is actually exercising.

A I, I haven't sat in on those specific rate making hearings, ~~that~~ **they** are ~~---~~ **pretty highly regulated by the state so**, that electricity, the utilities costs could be recouped in some manner.

Q Okay. And, well, let me just ask you, because you, yourself, participate in this as a buyer of electricity, are you aware that customers for electricity had the choice that either take an interruptible rate, or not ~~---~~ **it not imposed upon them by the state**, this is just an option that they can exercise or not, depending upon what they see as business needs.

A I am aware that could exist, yes.

Q And that is a choice you, yourself, have, I ~~have~~ assume that you ~~have got~~ **buy** electricity, right?

A I don't know if I have that particular choice.

Q Now, the Class I handlers pay a Class I premium in the Northeast Order, correct?

A Yes, they do.

Q And those handlers are paying, and involved in that Class I differential is $3.25, correct?

A Yes.

Q And it, it varies based upon particular location, but it never falls below $2.00, within the geographic ~~limited to~~ **limits of** the order, itself, is that right?

A That is correct.

Q And of course, so in that sense Class I handlers are putting more money into the pool than are being put in by any other handlers, correct?

A The, in almost every situation that ~~involves~~ **involved** the Class I prices, has been higher than any other class ~~person~~ **price.**

Q And -- the system is that the Class I differential is added to the higher of the Class III price, or the Class IV price, correct?

A Yes.

Q And so, necessarily, a Class I handler would be paying this much money, the Class I differential, more than the Class III price or the Class IV price, correct?

A Sure.

Q And, and, therefore, paying, and therefore, Class I handlers pay in the pool at least the Class I differential higher than the Class III handler and the Class IV handler, correct, the higher of?

A   Yes, yep.
Q   And let's say a situation --
A   Let me back up. I think the actual operation of the pool, they don't pay Class I differential. They pay a difference between the Class I price and the "blend" price of the plants. That is the actual pool payment.
Q   I, I, I~~ will give you~~ **agree with** that, but the ~~effect in~~ **effective** price is, that is being paid, is --
A   -- **Effectively what is pooled** is the differential, right.
Q   And --
A   Keep in mind, that it is based on the, the ~~fact~~ **fat** value, too.
Q   Okay.
A   As well.
Q   Now, the, the great benefit, of course, of the Federal Order system from the perspective of the producer supplying the Class III or IV ~~plants~~ **plant**, is that he or she gets to draw out of the pool not the Class III price, Class IV price, but the blend price, correct?
A   Now it is called the **producer** price ~~difference~~ **differential** ~~of~~ what they – **draw out.**
Q   Okay. And that is really sort of, ~~what~~ **that's** one of the things the Federal **Order** System achieves for

dairy farmers, correct?

A Yes.

Q And so, when your producers are supplying their milk in reality to make a Class III product or a Class IV product, the money that comes to them through the Order system at least, that includes money that really was paid not, by their handler, but by the Class I handlers in the pool, correct?

A When, when a load of milk gets delivered to **a** Class I distributing plant, and used in Class I, and it gets pooled, that higher value gets distributed equally to every ~~sharing~~ **producer on** the order.

Q Okay. And in your order, it is about 45 percent Class I.

A Yes.

Q And so, roughly half of the money is going to the farmers who, in fact, are not providing money to, providing milk to the Class I market, correct?

A I wouldn't say that, no, because when you ~~multiply~~ **quantify** the number of farms ship milk to Class I during the year, I can't do that, I don't know what that is.

Q I --

A It is like they wouldn't have --

Q Sure.

A -- ~~would have at~~ **more than half** the farms.

Q Okay. And, well, in terms of and you are right to make that correction, in terms of not farmers, but in terms of milk delivered, more than half of the milk delivered is receiving money that was actually paid by Class I handlers.

A Again, I would just, I would say 100 percent of the milk is receiving money paid by Class I handlers, because the Class I revenues are ~~---~~ **pooled across the entire order.**

Q Now, of course, the order system imposes an obligation on the producers -- Well, strike that.

Obviously the handlers who are handling Class III and IV products, want to be part of the Order because one of the benefits is that they don't have to pay their farmers the entire, what I will call blend price, rather part of that is kicked in by the Class I handlers, correct?

A It has been, again, the, the, all the milk pooled by, that is ~~going~~ **eligible** to be pooled by handlers, no matter what kind of plant they have, or any other business they ~~have~~ **are pooled** -- in the order, they all equally share in the proceeds to Class I market.

Q Well, that --

A As well as, as well as they all will share in the ~~---~~ **proceeds from the Class I market.**

Q But, but, a Class III or IV handler in paying his supplier, some of that money comes out of his pocket and some of that money comes out of the pocket of the Class I handler, correct?

A Say that question one more time?

Q Yes. When a handler who operates a Class III or IV plant, is, is, with respect to how much money goes to the farmers for the milk that goes into this plant, some of that money is coming from that Class III or IV handler, and some of that money is coming from Class I handlers in the market.

A There is, ~~one~~ **a blend** price of the Order, all farmers in the pool receive the same blend price relative to the adjustments that are made for -- delivery. They all share equal in Class I proceeds where they are, milk goes to Class I, II, III, or IV.

Q And the blend price is higher than the Class III or IV price, right?

A Historically it is almost always that way. There have been a few times that hasn't.

Q And, and, and, and, that difference between the blend price and the Class III price or the Class IV price, is being made up of the contributions to pool **by the** Class I handlers, correct?

A Sure.

Q And the Class III -- it is nice to be a Class III or IV handler in the sense that some of the money that is going to your farmers to generate the milk to run your plant, is actually coming ~~off --~~- **not from you, but** from Class I handlers, correct?

A Any milk delivered to Class III or Class IV just, comes from us. We would transfer the appropriate PPD to the ~~--~~- **producer** membership, that we pay.

Q Okay. And, and I take it you ~~are~~ - -

A ~~including~~ Including the appropriate people, including the transfer ~~if~~ **of** appropriate PPD to the members that ship to your member ~~craft~~ **Kraft** in the system.

~~A~~ **Q** Well, I am sure to all of our members. But, the, my point simply here is that part of the price of, strike that.

A Part of the money is going out to your farmers, is coming from the Class I handlers. Part of the money that goes to any producer that is pooled in the Northeast Order comes from Class I handlers.

Q Right. Now, and some of the producers ~~or~~ **are** actually the ones supplying the Class I plants in some part, correct?

A I would say some of them, yes, I would say some are, and some aren't.

Q Now, the, the, if the Order, this is sort of a, something of a quid pro quo in the system as to say that the quid so to speak, is that you get **to** draw money from the Class I handlers, if you are a Class III or IV handler. And the quo is that you have to ship a certain amount of milk to the Class I handler during the year to qualify to be pooled, right?

A Correct. There are pooling qualifications.

Q Okay. And, and that is, okay, and that is the quos, so to speak, with the quid pro quo, right? You get the money, but you have to provide a supply, right?

A It is not a part of the quo, not in our business. I guess I don't like the word you have to. We have very strong and very important Class I customers who rely upon our service of getting milk venue when they want it. They are very important customers to us and we are very fortunate to be able to serve them.

Q Well, I am speaking here only in terms of what is required by the Federal Order system. You are required to ship a certain amount of milk to --

A There is a minimum requirement of, in order to pool milk, of shipping a certain amount to a ~~distributor's~~ **distributing** plant.

Q Okay. Now, and, in fact, that amount is very much tied to the question of, well, strike that.

I mean, the whole part of this concept of balancing the ~~---~~ **milk you have advanced** is that you have to be in a position to supply more milk in the fall, right, because that is when the milk is needed for Class I, right?

A That is correct.

Q And, in fact, that is when you are required already to ship milk in order to qualify to take the ~~---~~ **money** from the Class I handlers, right, that is to say during the months of September, October, November, that you have to ship at least 20 percent of the milk received at the plant or divert it from the plant, to a Class I handler to qualify for pooling, right?

A ~~---~~ **For dairy marketing** services, we have to at a minimum ~~need to require to ---~~ **meet the requirements that you state** but for our business that ~~had~~ **has** no impact on that business because we are so much --

Q Okay.

A And on a regular, on a year round basis.

Q But, that is your obligation, your obligation, your minimum obligation if you want to pool, correct?

A That is the minimum obligation that is written in the **marketing order**. -- Another proposal of ours is to strengthen that obligation during the first part of the year.

Q All right. Okay. And --

(Pause.)

BY MR. ROSENBAUM:

Q What is the current **over** order premium on Class I milk?

A It is ~~--~~- **proprietary information.**

Q What is the published number?

A We don’t publish a number.

Q What is the number published by the USDA?

A I don’t know.

Q There is ~~no~~ **an** order premium, correct?

A There are **over order** premiums --

Q Are they highest on Class I milk?

A Pardon me?

Q Are they highest on Class I milk?

A As compared, is that what you are saying?

Q Yes, as compared to other classes?

A Not necessarily.

Q Are they generally highest on Class I milk?

A There is a market out there and we, we didn’t create the market dynamics, but we have to compete in the market place where they exist, and depending on supply and demand, the relationship in the market, market ~~--~~– **premiums** can be about the same no matter where you ship your milk, because you have to pay so much in order to be able get the milk, because we have to pay it out to the farmers to keep them in our system. So, at any given time, Class III handling charge can be the same as a Class I or Class II or Class IV.

Q Well, from the historical basis, let’s say since Order Reform January 1, 2000, had Class I premiums been higher than the other class premiums?

A Well, at times they, at times they have been equal or lower.

Q Have they generally been the highest over that time frame?

A I am not sure.

Q Now, the Class I handlers pay those **over order** premiums because they want to, or because the supply, the conditions are such that supplies of milk can demand it?

A It is a supply and demand interaction generally.

Q Okay. All other the things being equal, I assume, they wouldn’t want to pay ~~any~~ **an over order** premium at all?

A There is, all things being equal, sure, probably that ~~being~~ **would be** the case.

Q And --

A I don’t want to say that. We have got a very good relationship with all our handlers and it would have to be a pretty serious over supply situation for a handler’s charges to go down to zero. Even if that was the case, prices would be so low that there shouldn’t even be handler’s charges -- just to encourage, I don’t know, **there still may be the handler's charges in** -- the market. I can’t, I can’t, I can’t testify to what that interaction would have in some cases.

Q ~~Had~~ **Have over-order** premiums risen and fallen over the last two or three years?

A Yes, sir.

Q Did Class I premiums go up substantially in August of 2001?

A Yes, I think, I don’t know substantially, I know, they went up, I don’t know in terms of substantially -- From the dairy farmers’ perspective -- they probably wouldn’t think it was substantial.

Q Well, okay. And, and that was because the supplies of milk, supply condition were such that supplies of milk were able to demand and obtain that higher price.

A It was a situation where in order to encourage the milk to flow the way it needed to flow, and to be able to retain the milk supply, so that we have the milk to ship to our customers, we had to pay our members ~~high~~ **higher** premiums. We don't have any product that we sell and we can mark up to a consumer to get that money and so our only ability to pay our members more, higher premiums is to ask those who buy milk from us to pay us more. So, the situation would occur that if, if they hadn't done that, we wouldn't have been able to maintain the milk supply that ~~---~~ **they need for** their plans.

Q You had some figures as to utilization at the Dietrich plants, and I wonder if you could look at figure one, which is the Reading plant.

A Okay.

Q Although maybe you can answer this question without looking at the document at all. You have monthly figures that show the pounds of milk handled versus, what I assume is a plant capacity of about 52 million pounds a month, is that right?

A Yes.

Q And my question is on an annual basis, am I right that this is over 60 percent plant utilization?

A Is that -- On table two?

Q I am looking at figure one.

A No, no, I am going --

Q You can answer that whatever data you want to use.

A I am going to describe it the way you can calculate that.

Q Okay.

A All right. If you took Table 2, the Reading plant where it says total and there is a billion pounds of milk there, divided by the number of months and compared it to that, 51.7, if that is 60 percent then, then that is 60 percent. If you follow the calculation --

Q I am not sure I do.

A Again, I don't understand your question then.

Q Well, it may just be I can't follow your calculation and you need to help me out.

A Okay. Take total plant receipts, the total pound.

Q That is how much you actually took in.

A Right. Divide by the number of months and say that it is, I don't know, to make is simple, say it is 26 million pounds a month is that calculation. And if I am saying that the Reading plant capacity is about 52, then the answer to your question I would say would be 50 percent.

Q I see.

A Okay.

Q All right.

A And I didn't calculate that, but it is ~~--~~– **available.**

Q Okay. That is how you would do it. All right, thanks.

Now, the Middlebury plant --

A Is that the question you were asking?

Q Yes, that is, you have explained to me how, I was asking for the actual number -- That is fine.

But, the Middlebury plant, I take it is a pretty small plant.

A Yes, it is about a million pounds per day **capacity**.

Q So, it is, it is actually almost exactly half as big as the Reading plant, correct?

A Correct.

Q Which in and of itself is not that big of a plant.

A By today's standards, no.

Q By today's standards. Okay.

Does Dietrich participate in the, in the ~~NAS~~ **NASS** survey?

A I don't know that.

Q Okay. The survey I am referring to is the local people submit what they obtain for --

A Yes, I really don't know. They may, I just don't know.

Q Okay. Now, we heard a figure yesterday that ~~there is~~ **the** seven ADCNE plants handle 65 percent of the milk in the Order. I don't think that was your testimony, but is that right as far you know?

A I, yeah.

Q And, and the ~~independence~~ **independents** are about 25 percent of supply ~~--~~- **, right?**

A Yes.

Q Now, do you know and so together those two are 90 percent, right?

A Yes.

Q And, and Allied and others make up the remainder of 10 percent, is that right?

A Depending on where you are going ~~-- in the cooperatives~~ **on the cooperative list**. There are certain cooperatives that are listed there that are member cooperative of Dairylea. And they ~~--~~- **pay dues to** Dairylea members, and their milk pounds are market and pretty much the same pounds, except that they have their own existing ~~--~~- **data structure**. Their production is included in ~~Gary Lee's~~ **Dairylea's** numbers, and they would be included in the 65 percent. So, for instance, someone ~~might~~ **like Canisius,** ~~--~~ cooperative ~~---~~ **United** Madison, and Mount Joy Farmers Cooperative, their milk is included in that 65 percent. So, it is not -- So, your question, I think, is getting to does the remainder of the list have the other margin, no, not all of the remainder of the list because some is included in our ~~---~~ **number.**

Q How much of the remaining 10 percent does Allied have?

A I am guessing at this, I don't know. I would say Allied is between a billion and a half to a billion eight pounds a year, but that is a guess. I don't know for sure.

Q And under that assumption, what range do they, what percent do they handle of the 10 percent that is left over after accounting for the seven ADCNE members ~~---~~ **in the 25 percent of the pool.**

A I -- I don't know, see it was calculated -- I am guessing -- what is that over the amount of milk in the pool, some percentage, so I am not quite sure what it is. It might be around five percent, maybe, a good guess.

Q Are you saying they, they are half of the remaining 10 percent --

Now, this --

A The calculations --

Q You have identified and can you, you have identified that 25 percent of the milk is independent, is some of that actually marketed through cooperatives?

A Yes, sir.

Q And how much of that 25 percent of independent milk is marketed through the cooperatives?

A Well, I think DMS is the only one that does that, and that is proprietary, I am sorry.

Q Now, getting down to how the, another sense of how the marketing works, the seven ADCNE members, O-AT-KA is actually a joint venture owned by --

A Dairylea, Niagara, **and** Upstate.

Q Okay. So -- But, is it equal shares?

A No.

Q ~~What ---~~ **Who owns the most?**

A It is based on the proportion of the milk that is ~~at~~ **put into** a plant over a period of time. I believe ~~Gary Lee~~ **Dairylea** is the smallest, I am not positive. Upstate would be the largest.

Q Okay. And do Dairylea and DFA jointly market all of their milk in the Northeast?

A The, the member milk, the Dairylea and DFA member milk, yes.

Q And are there joint marketing arrangements between any other members of ADCNE?

A Not ~~on a ---~~ **where we're** jointly marketing milk. We have, I think Dennis mentioned yesterday, **Northeast milk** marketing agency which is a pricing mechanism but not a ~~market~~ **marketing** mechanism.

Q And who does that involve?

A ~~Gary Lee, GFA~~ **Dairylea, DFA** and I think -- DMS, ~~---~~ **Maryland and** Virginia Milk Producers, Land 'O Lakes, and Advantage ~~Terry~~ **Dairy** Group.

Q And ~~wasn't that always~~ **what does that organization do** -- for those entities?

A We, we jointly implement premiums in the southeast Pennsylvania, southern New Jersey and northern, and Maryland/Delaware area. And from time to time we will take common positions over Pennsylvania **Milk Marketing Board** -- in matters relating to the Class I Order premium ~~---~~ **it administers.**

Q How much of the milk does it control in the area that it covers?

A I don't know.

Q Do you know whether it is a ~~---~~ **novelty** position?

A What?

Q Is it a ~~--~~– **novelty** position of milk supply?

A No, it is not.

Q Is it 50 percent or more of the milk supply?

A I, I just don't know. I don't -- It is not, it is not that simple. We don't have a geographic definition for our, our match, so it is very difficult to come up with a percentage.

Q In, in Table 1, I guess this corresponds to testimony, let's see on what page.

(Pause.)

MR. GALLAGHER: Let me help you out. On that first column --

BY MR. ROSENBAUM:

Q Yes. If you compare there the cost of, involving to Locke, New York to the Tuscan Plant versus the O-AT-KA plant, is that right?

A Yes, it is.

Q Is the, are there other supply plants closer than O-AT-KA, to that location?

A Yes, there are, ~~they have been~~ **in a** given time, ~~they can be use both~~ they may be full. And this is a normal balancing pattern for the flush.

Q Is Middlebury Center closer than O-AT-KA for the allocation?

A I believe the cost to get to it -- to go on the road -- would be greater to get to O-AT-KA, which is going on the thruway and go. It is a lot easier. I will say that regarding our interactions with O-AT-KA, as you can see, something like that is not a very good economic return to us and I will tell you that O-AT-KA is the first place we ~~stopped~~ **stop** shipping milk to when it is needed somewhere else.

Q This is not a transaction in which you would, this would not be your first choice --

A No.

Q -- ~~about~~ **of** what to do with the milk if Tuscan doesn’t want it, right?

A Right. And I would say ~~on~~ that hauling costs, ~~there is a -- Farm~~ that's a load a day farm that is doing that, and if we ~~have~~ **want** that ~~down as~~ **balancing** cost on farms that are not ~~---~~ **load a day** that, that net cost savings would be different.

Q Turn back fees. How often do you charge those?

A Not very often. I think there is only one customer that ~~utilizes~~ **we utilize them for**, I am not positive. In fact, it was because we didn’t sell them a lot of milk, and they were really **tweaked** -- pretty hard, so they had to do something to discourage it.

Q And the way you discourage it by charging more money.

A Yes. Many times, especially in the extreme flush, it doesn't come anywhere near to cover what it costs us to find another home for that milk.

MR. ROSENBAUM: That is all I have at this time.

JUDGE BAKER: Very well. Thank you.

Yes, Mr. English.

We are 10 minutes away from our morning recess.

EXAMINATION BY MR. ENGLISH:

Q Good morning, Mr. Gallagher.

A Good morning.

Q Let me start off on a couple of things that Mr. Rosenbaum has touched on.

And you mentioned the fact that periodically, the group takes a group position before the Pennsylvania Milk Marketing Board. And it is correct, the Pennsylvania Milk Marketing Board charges Pennsylvania processors, **on** Pennsylvania produced, Pennsylvania processed and Pennsylvania sold milk ~~at~~ **an** over ~~border~~ **order** premium in Pennsylvania of a $1.65 at this time, correct?

A Correct.

Q And in addition to that $1.65 premium, it is correct that Pennsylvania processors also pay cooperatives a over price, over price **premium, a premium that** ~~-- and it~~ is even above the Pennsylvania $1.65, correct?

A We pay a handling charge on top of that.

Q And that handling charge on top of that, is charged those **Class I** processors in Pennsylvania as part of the cost that you need to get back out of the system to cover your costs to supply milk to Class I **milk** market, right?

A The, ~~we ---~~ **take any one of** the customers we represent from the United States Dairy Foods that has a producer milk supply. They have a cost involved in procuring that milk supply and ~~we~~ **you** have to have ~~how to train fluid~~ **highly trained field personnel**, to go out and inspect farms. You have to have a dispatch system. You have to have an accounting system, a payroll system. That all costs them money. The handling charge is a charge that identifies our cost to ~~that ---~~ **do that for them.** That is why there is handling charges.

Q But, in your case, you have said in the past that the handling charge includes the cost of balancing.

A I may have, I don't know. I don't recall.

Q Do you remember testifying before the Pennsylvania Milk ~~Market~~ **Marketing** Board on October 3, 2001 with respect to the $1.65 premium and the questions you were asked --

A Can you read what I responded to? The question --

Q It was a question by the attorney for the Pennsylvania Milk ~~Market~~ **Marketing** Board, Mr. Everly. If the Board raises the ~~---~~ **over order** premiums, how is that going to help the dairy farmers long term profitability if they are already receiving prices higher than that, which is the mandate the order premium is? And the question, answer, the prices that exceed the overboard premium are part of the costs we need to get back out of the system to cover all costs ~~supply -- with~~ **supplying milk to the** Class I sector. So ~~---~~ **any 10 cent increase** is going to end up going directly back to the farmers that we pay ~~-- the market~~ **the Pennsylvania milk marketing** price to. Question: I guess I didn't understand that. ~~The answer~~ **Answer**: Let me -- Question: Yes, please. Answer: Class I **handlers** do not take the ~~---~~ **same amount of milk** every single day. They will take typically, there will be some **mid-week** day where they will **peak**, they will have the highest amount of milk they need and every other day will be less. When you get to a weekend~~---~~ **,and you take significantly less generally** ~~get less~~ on the weekends, however, we arrange the supply, because we have to make sure we are committed to make sure our Class I customers get all the milk they need, when they need it. We have to make sure we have seven days a week, enough milk available for them to get their peak, order all the time, because we can go and commit that milk long term to say a cheese manufacturing plant. You have to have it available ~~in~~ **to** the Class I market. And so, we only get a premium on the milk we deliver to the Class I plant. We don't get that premium on the milk we don't deliver and we have to keep back on the reserve because we can't -- **make any** long term ~~committed~~ **commitment** to any plant, not only because ~~of the -- changes~~ **they have got changes in weekly needs**, they have changes in ~~seasons~~ **seasonal** needs. During summer months when schools are out, ~~classroom -- significant ---~~ **Class I plants take significantly less milk** as they do in the fall ~~. The school is~~ , **with schools** back in session. So, ~~---~~ **why this** milk, which is a reserve they need what we call balance, we can't cut a price **to a plant**, -- a guaranteed value of milk for a year on that and -- So, we have to take whatever the market **will allow.** ~~--~~ That **is all an** answer is to a question about what ~~--~~ **an** over **order** price premium **is**, do you remember that testimony, sir?

A Sure.

Q Thank you.

In calculating on Table 3, the Dietrich’s loss, in that column, either column for January to July 2002, and 2001. Did you include any --

A Where --

Q I am on Table 3 of Exhibit 19, which is your balancing costs.

A Okay.

Q Did you include in either column from January to July 2002 or for 2001, any monies collected from Pennsylvania, the $1.65 you collect on Class I that is the Pennsylvania ~~--~~– **over-order** premium to reduce that loss?

A No, because we had to pay it all out to producers to keep their milk supply.

Q And did you include any portion of the, of the, as you testified, portion of the -- $1.65 that is for the cost of supplying the Class I sector. Did you apply **any** of those portions in calculating the Dietrich’s loss in the first or second columns for January to July 2002 or 2001?

A No.

Q Do you purchase milk from other sources that are run in the Dietrich’s plants at any time?

A We take milk into Dietrich’s from wherever we can get.

Q And sometimes those sources are not your own sources, they are not your own milk, correct?

A Correct.

Q And at times when you purchase those other person's milk, do you ~~carry~~ **pay** a price other than the class price for that milk, something less than the class price?

A We may, I don't know. But, I also know we may pay ~~an interim~~ **a handling** charge for it as well. But, I don't know how often we do or don't.

Q But, you --

A Any, you are referring to another class price situation and we buy another class price, any profit or loss in the total for the year, for all the purchases is reflected in there. So, if there is a load or two that we get it under class pricing, that somehow marginally reduced to loss, possibly.

Q But, you ~~are not ---~~ **aren't getting** any premium that you collected in the marketplace in those calculations, correct?

A We -- If, if Dietrich's, no, I mean --

Q Premium class milk, any premium, whether it is Pennsylvania or throughout the Northeast ~~corridor~~ **order** that you have collected for Class I or for that matter

Class III milk, you have not used that money in any way as a calculation in those columns on this table, correct?

A No, because it is not a revenue for Dietrich’s, it is a revenue for DMS and we expend that money in the country to keep producer’s shipping to our organization or organizations.

JUDGE BAKER: That brings us to 10 o’clock, our morning recess.

(Whereupon, a short recess was taken.)

JUDGE BAKER: Back on the record.

BY MR. ENGLISH:

Q Mr. Gallagher, do you have Exhibit 5 with you?

A Yes, I do.

Q Would you turn to page 79-A?

A Okay.

Q And again, I believe you were in the room when I asked Mr. Wellington and Mr. Shad questions.

A I may have been.

Q I was asking for the data that is prescriptive on page 79. For instance, starting in January of 2001, can you tell me whether DMS, **Dairylea,** or DFA transferred milk to Order 6, **the Florida order,** -- and I **caveated that** -- when I asked the questions of Mr. Wellington and Mr. Shad by saying I recognize and asked them for confidential information and ~~--~~- **if you choose not to answer, fine,** but, I want to ask and see where you will go.

A I, obviously, I am not going to give you specifics, but I don't believe, ~~number~~ **order** six is ~~referring~~,**what order?**

A **Florida**, I believe, I don't believe we transferred any ~~--~~- **milk there, no.** If we did, I don't know.

Q And that would true for other months for Order 6 in 2001 or 2002?

A Yes.

Q How about Order 7 for January of 2002, do you know whether --

A The ~~Northeast --~~- **Southeast Order?**

Q Yes.

A I am not -- I am not aware of transferring milk to Order 7, but again, we may have, but, I am not aware of it.

Q And the ~~with the~~ we in there, it would be DMS --

A DMS, DMS, it would be.

Q So, you wouldn't know whether DFA --

A Well, in that we ~~were, DFA is --~~- **operate DFA's Northeast area council.**

Q So, for this purpose, for Northeast Council, the answer would **be** included, **the Northeast council** -- for DFA?

A Yes.

Q How about transfers -- plant, other plants for June of 2001, there is restrictive data, data showing from Order 5. Do you know whether there were transfers from Order 5 --

A That?

Q That came to DMS facilities.

A Dietrich's.

Q Dietrich's.

A There may have been. I don't know.

Q Turning to page 80. Diversions to other **order** plants. For January of 2001, can you tell me whether DMS had diversions to other ~~little~~ **order** plants, like Order 5 would?

A At some point in there we did. I am not sure when and how frequently.

Q You wouldn't have the volumes?

A No.

Q Thank you.

(Pause.)

THE WITNESS: It is, I can say it is minimal, minimal -- five.

BY MR. ENGLISH:

Q Can you tell me what minimal is?

A Minimal is, let’s see, a very small percentage of what was ~~--~~– **marketed.**

Q Do you know whether Maryland/Virginia is moving milk on Order ~~50~~ **5** diverts milk back to its ~~--~~– **Laurel facility** in Maryland?

A I don’t know. I am not versed to the operation of that cooperative. I can’t answer that question.

Q There were a number of times in your testimony you were discussing costs that were incurred for ~~--~~– **balancing** and by way of example, on page four, you discuss the term “opportunistic” pricing. And then you explain it. You agree that opportunistic pricing occurs regardless of whether the seller under these circumstances is a cooperative or ~~high carry~~ **proprietary** operation?

A Yes.

Q And similarly, footnote on page six, Footnote 5, which describes similar kind of transaction. There is no differences as to how a cooperative is treated as opposed to a proprietary operator, where they be trying to unload milk, correct?

A Not necessarily. Not necessarily. There could be a difference.

Q And that difference would be that the proprietary has planned for this or --

A No, the difference is that sometimes the, there is a different interaction between some of the ~~--~~– **cooperatives**, sometimes they aren't as aggressive in, in, in pricing in these opportunities, because there are other interactions that are going on between the two organizations, that is just, result in not having as an aggressive pricing ~~--~~– **scheme.**

Q So, other decisions get factored in, that impact the return?

A Sure.

Q So, these decisions would be other economic decisions?

A Sure.

Q Some of those decisions would be relational decisions?

A Yes.

Q Does DMS charge its customers differently, two different style customers, a customer who is a full service customer receiving all of its milk needs year round, versus a customer that receives, that in your term uses independent producers for its primary source and then balances using DMS? Is there a charge difference by DMS for those two customers in terms of premium or a handling charge?

A I am not sure.

Q To the extent that you discussed Mr. Miller's testimony ~~in length~~ **on "renting"**, you would agree that the step that he also for that company or others made that facility available to proprietary the same costs are incurred there as well?

A No. What do you mean by the same costs?

Q If there is a ~~hauling~~ **tolling** arrangement for disposal ~~for plus~~ **of surplus** milk, that the ~~hauling~~ **tolling** arrangements would have the same impact on proprietaries that they would on a cooperative?

A Yes, relative to whether, I don't know what the charge would be. I can't testify whether the charge would be the same.

Q You have no reason to believe the charge is different.

A I think, I think Mr. Miller testified that there, he has got some contractual arrangements with some people that would have different pricing characteristics than people that are just on the spot market.

Q And that is ~~---~~ ,**generally speaking** all spot people would be treated similarly, but ~~as ---~~ **not as contract people.**

A I, I have no idea how, how he prices the others. It could be a different price, I don't know. It could be the same price.

Q On the top of page eight, you refer to, "Since Federal Order Reform, the dairy cooperative members of DMS have taken on additional contractual obligations for supplying certain Class I customers with 100 percent of their milk needs." Did some of that, some of the other contractual obligations occur as a result of merger or membership of cooperatives within DMS?

A They occurred due to their relationships that Dairy Farmers of America has developed with some of their customers nationally and --

Q And so those were relationships that were voluntarily undertaken as a result of contractual obligations that DFA had undertaken on a national basis, correct?

A Correct.

MR. ENGLISH: I have no further questions. Thank you.

JUDGE BAKER: Thank you, Mr. English. Are there other questions? Mr. Vetne?

MR. VETNE: Yes.

EXAMINATION BY MR. VETNE:

Q Could you identify the Class I customers to which you and Chip English made reference in the last series of questions?

A I don’t think its a secret. Dean Foods, and National Dairy Holdings.

Q Are those plants listed under the, either Dean Foods or National Dairy Holdings in all cases in Exhibit 5?

A Probably -- It will be, there is Tuscan -- **Lehigh** Dairies, Terrell Farms, West ~~Linns~~ **Linnsville Dairies** -- There is, maybe Grants, maybe.

Q Grants is not -- To Farms of Maine.

A Okay. Yes, and I don’t know if there is a Cumberland down there. There may be or there may not be. But --

Q Cumberland Dairy, Inc. of New Jersey?

A No, not that one. This is ~~--~~- **baby** Cumberland.

Q At what location?

A At New Jersey, which --

Q Cumberland.

A There is a Cumberland, Cumberland Plant in Flores, New Jersey, that is part of Dean Foods and the other one is Bridgeton or something like that, it is ~~--~~- **baby** Company.

Q You referred to, in response to questions from

Marvin to Upstate plants. And you also made reference to Upstate operations in Buffalo.

A Yes.

Q Are there more than one Upstate plants in Buffalo?

A I am not sure. If that Class II ~~is~~ **business**, I don't know if that is a separate business. Somebody mentioned the name **and I didn't take the time to look** -- but, ~~it~~ **there** was a facility that they thought might have been their Class II operation.

Q In Exhibit 5.

A Direct me to what page.

Q There is a list of partially regulated distributing plants and an Upstate plant in Buffalo is identified.

A Okay.

Q Do you know whether that is a separate Upstate facility dedicated to Class I essentially?

A I think that, they do have a Class I facility in Buffalo.

Q And which is, that Class I facility is separate from their manufacturing?

A It may be. That is the part I am not positive about. There is something here, it was pointed out, there may be another Upstate facility and ~~that~~ **when I** was ~~--~~ **interviewing** Upstate, I forgot to ask about that.

Q Okay. You do not know, do you think you could find out if the, ~~parts of the~~ **partially** regulated Upstate **distributing** plant in Buffalo is also the Upstate Class II manufacturing facility that you described or was it that they were separate?

A Is that one of your customers?

Q Pardon?

A I ~~think~~ **bet** your client would know. No. That is not a right answer? I can try and find out, sure. I will be back at, I have another part to testify on our pooling provisions, and that will probably tomorrow and I will find out by then.

Q Thank you.

Within the past **10 or** 15 years, has there been any change in the number of manufacturing plants to which surplus milk, that is not Class I milk, maybe marketed in the Northeast?

A Yes.

Q Has there been closing of a number of manufacturing plants?

A Within the 15 years, there has been closings, yes.

Q Has there also, say within the last five years, to your knowledge, there has been a change in the manner in which those plants are supplied?

A Yes.

Q Since Federal Order Reform is it not the case that a number of manufacturing plants now receive milk by contract with cooperative associations that prior to Federal Order Reform received independent producer milk not through cooperative associations?

A Since Federal Order Reform? ~~That should,~~ **Im not sure of the number,** I know of at least one. I don't know the number, there is at least one that I know.

Q When you mentioned the cooperatives that are part of Dairylea, **Im not sure if you mentioned Lyleville C-op,** ~~-- connection,~~ is that part of Dairylea or is that marketed through some other cooperative organization?

A We market their milk but they are not a member.

Q You ~~---~~ **qualify** their milk?

A Yes.

Q So they are not in their own capacity an ~~IC~~ **9(C)** handler?

A They are not an ~~IC~~ **9(C)** handler, no, they are current.

Q Has DMS, to your knowledge, were participants voluntarily taking milk off the pool in order to take advantage of a class price that exceeded the expected lot in the Northeast market?

A Due to the competitive nature in the market and the need to be able to compete with others, from time to time marketing opportunities that, you know, take advantage of the same as others in the market have taken advantage of. And so from time to time that may have occurred, but not in any kind of significant volume.

Q And that would be on Class IV milk?

A It could be, yeah, it could be included in Class IV **milk.**

Q Would that also have included Class II milk?

A It may have.

Q And would I be correct in assuming that it probably didn't include Class III milk?

A I am trying to think of ~~the situation in ---~~ **a pricing relationship.** I can't recall **a pricing relationship** in which that would have occurred.

Q On page four of your statement, you describe the importance of finding a plant market for your member milk, for the milk, for organizations that you market. Were you here for the testimony of Bob Wellington?

A Parts of it.

Q You read it?

A Yeah.

Q Did you intend to mean the same thing as Bob did or as Bob appeared to mean in his statement when he referred to finding a home for milk?

A No. ~~--~~- **I don't know the** specific part of his testimony ~~--~~- **you're referring to.**

Q Well, let me rephrase.

When you described the need to find a plant to market milk, do you accept the ~~characteristic~~ **characterization** of that as ~~a --~~- **an important factor in** finding a home for all your milk?

A Yes.

Q Am I correct that finding home, you, you include in that, that mean for a pooled home?

A Correct. Our balancing costs would be significantly higher if we weren't able to pool milk.

Q That was, that was --

A Because we wouldn't get the PPD.

Q I was getting to get to that. I don't -- the question has sometimes been asked, you know, why don't you just depool your milk and save all this trouble with the Federal Order System. Is that an ~~action~~ **option** for you?

A No, it is not.

Q And why not?

A The, the, one of the ~~---~~ **marketplace** has a price and it is based on the pooling price and premium of producers and if you don't pool the milk, you don't get the blend price. And you are likely not able then to ~~---~~ **pick, you need to do better than** any price in the country, you won't be able to ~~,~~ **keep** your milk ~~---~~ **supply.**

Q I was getting to that, too. And if you couldn't pool your milk, what do you believe would be the rational economic responses of **the** farmers ~~---~~ **who can't pool.**

A They would find somebody who, they would switch to a handler that could pool their milk.

Q You made some reference in response to questions from Chip English to Pennsylvania and indicated that DMS markets milk to Pennsylvania handlers. Does that include Pennsylvania handlers that are part of the PMMB system, but not fully regulated under the Federal Order?

A Yes.

Q And with respect to that milk, does DMS receive an individual handler blend?

A ~~I need more specific~~ **Im not going to get into the specifics** of what our return is on that. But, it is a competitive return.

Q I am not asking for a --

A There is, there is a requirement under, there is a requirement of Pennsylvania Milk Market Board that requires that for the milk that is delivered to that plant, that is priced under the regulation, that that return be weighted average plant volume included in whatever mandate premium by the Milk Marketing Board is in place at the time.

Q Which is effectively negative or handler pool for that.

~~Q~~ **A** Yes.

Q Do you identified ~~towing~~ **tolling** costs, one form of ~~---~~ rent incurred at balancing the market.

A Yes.

Q Would it be correct the need to ~~invest~~ **adjust** the cost for ~~towing~~ **tolling**, as balancing should be refined to mean the difference between the processing or conversion costs and the cost and price that you actually pay for the conversion service? And maybe I should, let me start ~~---~~ **this up.**

When you pay a $1.00 of ~~towing~~ **tolling**, you are paying the Board certain processing service, correct?

A Yes.

Q There would be a cost to process, regardless of who did it, whether you did it yourself or paid somebody else?

A Yes.

Q So, when you pay a $1.00 for processing, it is not a dollar off the classified price, the amount that you would realize for that milk, ~~if that is~~ **that reflects** a reduction, and the price available to producers, is the difference between the cost of converting raw milk to something else, and what you are actually paying for it.

A Can ~~I at least~~ **you please** give an example?

Q Yes, sure.

A Suppose we ~~tow~~ **toll** somewhere and we get charged a dollar under weight on a load milk. And so it is ~~---~~ **condensed** and then the condensed ends up at a cheese plant, and ~~depending~~ **converting milk** on what they pay is the equivalent of two ~~hours~~ **dollars** under class. Our cost to our operations, say the class price is $11.00, we have got a dollar in ~~towing~~ **tolling** and two dollars in under cost pricing, so there is three dollars less, there is three dollars in cost there, plus there is probably say 75 cents to a dollar handling, that we are not getting, and so say it is 1.00, so, there is $4.00 in cost there that we have to eat because we are going to pay the farmer the Class III price, the PPD and his premium that is based on that 75 cents or dollar that ~~--~~– **we would have gotten in handling.** So, we have cost of say it is 11, we have got cost, **we got a payment to the farmer of** ~~have~~ $12.00, we really, that ~~is only~~ **sales that are** returning us, what, $8.00, so we were $4.00, yeah, a $4.00 cost. Does that get at what you were --

Q Not quite. Let’s say that the, the alternative condensing location is O-AT-KA, and milk is received at O-AT-KA, **put into** condensed and you market it for whatever, whether it is to a cheese plant or an ice cream plant, there is a condensing cost.

A Yes, sir.

Q And a condensing cost would be incurred by somebody, whether it is at the Dietrich plant or at O-AT-KA or Queensboro Farms.

A Correct.

Q When you pay a ~~towing~~ **tolling** charge, you are paying more for the service of converting milk to condensed products in the ~~towing~~ **tolling** fee than you would if you were doing condensed at the Dietrich plant for Allied Company, is that not usually the case?

A The ~~towing~~ **tolling**, the ~~towing~~ **tolling** charge is a service for a cost that is incurred. It is a cost to DMS that we don't normally incur, so it is additional cost to us if we incur that. I may not be following your question.

Q Okay. If you were to charge back the cost of condensing the milk, at O-AT-KA or Dietrich, would that cost be less than you would ordinarily pay for ~~towing~~ **tolling**, for example, at Queensboro?

A For the ~~towing~~ **tolling**, would the towing cost at Dietrich be the same as Queensboro. Is that what your question is?

Q Not the ~~towing~~ **tolling** cost, the cost to charge back for reducing producer milk to condensed products.

A I am sorry I am not following this. The, the ~~towing~~ **tolling** fee at the Dietrich or O-AT-KA may be different than a ~~towing~~ **tolling** fee at Queensboro.

Q All right. Is there a product that is, that on behalf of DMS or Dairylea that is condensed at O-AT-KA on a basis other than ~~towing~~ **tolling**?

A Oh, I see. There could be, yes.

Q I mean, what is the ordinary procedure, when you use the term ~~"towing"~~ **"tolling"** is ordinarily is all of or most of DMS milk that is condensed?

A ~~It has to be~~ -- If we sent a load into

Dietrich's for O-AT-KA, it is not on a ~~tow~~ **toll** basis. Is that -- It is based, there is a cost of, there is a cost of operating the plant ~~---~~ , **I guess is there,** and that gets built into the product when it sells and at the end of the day, you have got revenue ~~that is~~ **minus** cost, and at Dietrich's, if the revenue ~~---~~ **minus** costs results, you know, at the end of the day, at the end of month or whatever, results in a loss, that gets passed back. For any particular load that gets ~~---~~ **sold where** there is a positive margin, then that reduces the loss.

Q And is it similar at O-AT-KA?

A I --

Q Dairylea or DMS sends some milk, milk to O-AT-KA, the cost of converting it, gets charged back and the revenues, if any, get --

A When you say charged back, charged back to who, to Dairylea?

Q Yes.

A There is -- at the plant, then -- so, yes, it would in the end be charged back based on the usage ~~of~~ **at** the ~~---~~ **plant.**

Q Is there any kind of ~~---~~ **use-quota** at O-AT-KA based upon ownership interest?

A There is, but, there is, yes, sir.

Q Okay. And you were about to say --

A ~~--~~- **Im not going to reveal the** details.

Q When milk is condensed, and then marketed for cheese, do cheese plants pay premium for condensed ~~--~~- **for solids in** ~~into~~ condense over **solids in** whole milk?

A Not to my knowledge.

Q Is milk or cheese usually charged on a ~~--~~- **solids** basis?

A A load of milk sold to a Class III plant is going to be charged on a Class III components. I believe a load of condensed would be charged on non fat. A price based on the non fat ~~--~~- **solids.**

Q Components in both cases would ~~simply~~ **slightly** differ on component reference.

A Right.

Q And there is a savings, though, ~~basically~~ **in the case of** condensed milk and getting the milk to the cheese plant, transportation savings.

A Yes, cheaper to ~~-- to~~ **looking into** the point that say there is a three/one condensing, you basically you have a load of condensed, you are saving cost of shipping ~~to those --~~- **those two loads of milk.**

Q So, is a consideration in condensing to save transportation costs before it is all sold to its ultimate buyer?

A Yes.

Q I asked this question of Bob Wellington and he didn't know the answer for areas outside of New England. Are independent producers who have Class I customer, uniformly distributed throughout the milk shed, Order 1 Milk Shed, outside New England, or do they tend to be concentrated in any particular location or locations?

A They tend to be concentrated and they tend to be concentrated close to major highways, which is ~~---~~ **easy to pick the milk and get it** down to a major highway and ship it to the particular plant. And ~~it goes down to the~~ **they tend to be concentrated** concentrated, the areas of the milk shed that are closer to the plant ~~---~~ **than farther away,** to the extent possible. And they tend to be on average larger sized farms as opposed to smaller sized farms.

Q Do you, in the course of business, ascertain ~~paid~~ **pay** prices including over order premiums **paid** to independent producers?

A Yeah, our ~~feel ---~~ **field force** and our membership people have a pretty good idea of what each ~~individual~~ **competing** entity pays its producers in a specific area. As well as what kind of, not just ~~our~~ **on their** premium **and PPD**, but there could be a hauling charge.

Q Comparing apples to apples, that is producers in one area to their neighbors in the same area.

A Correct.

Q Do hauling charges differ that are charged to DMS member producers compared to independent suppliers or distributors?

A They may. In the net of the, what producers look at when they determine what their, who they are going to ship their milk to, they are going to look at the blend price **they get paid** and basically they look at that zone, and then they look at what their hauling charge is going to be and then they look at the premium ~~they can~~ **they're going to get**, and then ~~tack~~ **net that** together and then they -- independent and then on the cooperative side, they go through that same. The cooperative is, is, ~~has a~~ **another** marketing option, they go through that same calculation and then they add in ~~--~~- , **here's what a proprietary can pay.** So, here is a -- paid, here is what a cooperative can pay and then they add in dues and equity ~~--~~- **which shrink things.** So, those are things they look at. And of course, there is the marketing service **fee** on the proprietary side goes into the calculation.

Q You also, do you also look at and compare over **order** premiums, **on a** classified price basis, charged by DMS and compare that with over order premiums paid to independent producers?

A Yes.

Q And in making that comparison do you also impute to buyers of independent milk costs that are built into your premiums that they would incur on their own, for example, field representatives and payroll, etc., etc.

A Yes.

Q And have you observed making those comparisons similarities or differences in over ~~load~~ **order** premiums charged by DMS compared to over order producers prices, plus handler costs incurred by independent buyers?

A Yes.

Q And ~~are~~ **can** you **describe**, what, if any, of those differences are?

A It is my, I have seen that the DMS handling charge tends to be higher than that calculation for an independent producer relative to how you just described it.

Q DMS handling charge -- You charge above the class price?

A Yes, the total charge above the class price.

Q Okay. And ~~turning~~ **you're comparing** that on one side to **the** over **order** producer price, plus the imputed **handler** costs ~~---~~ **of the independently supplied side.**

A Correct.

JUDGE BAKER: Does that conclude your questions?

MR. VETNE: No.

JUDGE BAKER: I am going to -- 45 minutes.

MR. VETNE: Probably another 10 or 15.

JUDGE BAKER: Very well. I am concerned that, as all of you are, as to how much we are going to be able to get done today, I may interrupt some of your questioning.

BY MR. VETNE:

Q Is there a reason why DMS costs would be higher when you make those comparisons?

A Yes, let me give you an example of, well, actually ~~it~~ goes ~~out~~ on **in** the milk shed. I don't know who is ~~---~~ **the chicken or the egg**, but, a Class I handler needs a lot of milk. DMS is, you know, is a big, huge entity and milk marketing entity, that overlaps pretty significantly some special - - **that distributor needs another load of milk they end up on our farms looking for**

milk, and so, you know, they may need a load of milk and they recognize they need to raise their premiums, or eat the premiums for the producers they are trying to procure. They may be going around, and there is an actual case going on now with a New York State Dairy Foods customer that's offering $0.30 more than Dairylea farmers are getting paid. DMS in total, with all our members in Dairylea and DFA, and marketing relationships we've formed, don't have enough milk to meet all our customers needs, and so we purchase milk from other people into our organization. Because of that, we can't afford to lose farms and so we have to be competitive to ~~with those Class I distributors that have their own operation supplies. So, this big target -- We come to that and we can’t afford to lose ground, so we have to be competitive to~~ maintain our farms. So, when the proprietary handler is out there trying to sign up ~~for~~ **more** milk because they want to have more in their own system as opposed to buying it from cooperatives, and they wind up on our farms -- we compete, we are vicious in the field competing. We are not going to give up a farm, a member, but we have different responsibilities to our membership. So, when, if we have to raise the premiums to one of our farms, then to be equitable to the other members in the area, we have to raise the premiums there as well.

Now, ~~the~~ **if that proprietary** handler wants that load of milk, he will keep bouncing around until he can ~~get that --~~ **put that milk away** somewhere and we keep trying to follow him along, and so, when a particular proprietary handler needs a load of milk, it ~~didn't~~ **may** cost us higher premiums ~~and~~ **on** 20 loads of milk, in order to save our milk supply. The equity issue is different between the cooperative and the proprietary handler. The proprietary handler has no responsibility to, to pay equitably to all its producers, where a cooperative does. There is, there is a democratic process for cooperative members to go about in the ~~proper~~ **cooperative** situation. So, yeah, we need to have higher handling charges from our customers in order to maintain the milk supply that we have, and we end up spending that higher handling charge on premiums on farms to keep them competitive and in our system.

Q In response to questions by Mr. Beshore, you made reference to Holland Packer Cooperative. And in response to a question on difference, qualitatively as well as quantitatively in balancing services. In your description based on reference to that coop, you were referring to supplier organization that didn't supply all of the needs of a customer, and benefitted from somebody else supplying the residual, supply and balancing needs for a customer, am I correct?

A Yes.

Q So, with respect to a, a customer Holland Packer ships to, if somebody, an organization, supplied the needs and balanced not just, you know, **not just** on weekends or holidays, the qualitative aspect of that service would be the same on a one plant, serving one plant, as the qualitative service DMS balances ~~---~~ **within many plants.**

A Correct, yes, that is correct.

Q The qualitative difference then that, that is important to you and that underlies your proposal is that some folks ~~---~~ **are** not fully balanced a plant, or the market, whichever it is, and then either get a price benefit or a cost reduction as a result, and some other folks assume that producers, that balancing function, either the residual balancing for a plant that is partially supplied or a full balancing for a plant, for plants that are fully supplied, and producer prices, thereby, if it is a cooperative, are reduced because they are charged back to producers.

A Yes.

Q So, the target of your proposal is, effective non uniform prices from producers.

A Yes.

Q I think it was in response to questions by Mr. Rosenbaum, you agreed that there were producers, maybe a lot of producers, who don’t supply Class I to other plants.

A There are producers that don’t supply Class I to the ~~foods~~ **fluid** plants, but they qualify based on --

Q Somebody else’s --

A In association with somebody that, other producers that do.

Q Okay. Those producers that don’t supply ~~food~~ **fluid** plants, largely would be in the category on the graph that Dr. Ling showed us, I think it was of excess reserves.

A Yes.

Q Okay. And that is, that is **milk that is** not needed by Class I plants, necessarily, on either a daily or seasonal basis, but it is pooled for reasons of orderly marketing.

A Correct. Although from time to time, milk at the Canadian border, in New York, makes its way into a Class I plant.

Q Yes. What would happen if that milk couldn’t be pooled, if those producers couldn't share in the blend price regardless of how the milk is used?

A There would be a cost benefit economic analysis done by those producers to see if there was a way to ship to a plant that could, or a handler that could get them pooled and they would let the, take less of the price than the particular producer, that they maybe they will be replacing would receive.

Q Okay.

A And so, it would be a vicious spiral downward in pricing that would result in lower blend price throughout the milk shed.

Q To everybody?

A To everybody.

Q And that is the reason, in your opinion, that those producers are pooled and should be pooled because it mitigates inter producer price to **de-** stabilizing competition.

A Yes.

Q You mentioned in one place in your testimony that you, ADCNE and DMS transfer the appropriate PPD to its, to members. Would it be correct to say that the PPD that is transferred, may not be the Federal Order PPD?

A No, I don't know what you mean by -- It is, it is a, it is a, generally, it would be the PPD which would be Boston minus one of the zones. Is it the, it wouldn't necessarily be the PPD of plant that that particular producer shipped that milk to.

Q Okay. Dairylea or Dairylea and DFA, don't at any location pay less than the Federal PPD to members --

A I am not sure if that were to occur, it would ~~--~~- **be a compensating** increase **in the premium** and ~~the rate of~~ **a** compensating ~~would~~ decrease in the hauling charge. So, the net is a particular PPD.

Q Okay. And when premiums are increased in ~~the~~ **a** local ~~--~~- **supply region** as you discussed in response to procurement competition. It would be correct to say that additional premium comes from, effectively from the pockets of DMS producers elsewhere.

A ~~If you~~ **We** have got a ~~--~~- **pot of money to distribute**, we don't have any additional revenues, we are shifting revenues around, so if we are unable to go to the market and increase our revenues, we are shifting things around ~~--~~- **to balance everything out, to beat** ~~in~~ the competition.

Q Is that a yes?

A That, it could be a yes. It depends on whether we can go to the market to get the extra revenue.

MR. VETNE: That is all I have.

JUDGE BAKER: Very well. Thank you. Are there any other questions for Mr. Gallagher?

Yes, Mr. Stevens.

EXAMINATION BY MR. STEVENS:

Q Mr. Gallagher, when did you make your proposal to the Secretary for this Proposal 7 that we are discussing? And when did you make that proposal to the Secretary of Agriculture?

A Can I ask for help on that?

Q Sure.

THE WITNESS: Marvin, do you know the date?

MR. BESHORE: March 2002.

THE WITNESS: March 2002, according to Mr. Beshore.

BY MR. STEVENS:

Q Would March 8 --

A Yes, sounds good.

Q Does that sound like the right date?

A Yes.

Q March 8, 2002.

A Okay. Sounds good.

Q Thank you.

In your testimony on page 14, you noted for the record some information about the Act, which authorized, I believe, the, the Secretary to implement marketwide services under the, under that Act.

A Yes, sir.

Q Right.

MR. BESHORE: Not to hold things up here, the provision you referenced in the Act was not the Act which authorized marketwide services. It was a separate piece of legislation, which directed the Secretary with respect to the timing of the procedures concerning marketwide service provisions.

MR. STEVENS: Not the Act of March 20, 1986.

MR. BESHORE: Yes, that is what Mr. Gallagher's testimony references that Act, but the marketwide services provisions were authorized by the Food Security Act of 1985, which is a prior legislation.

THE WITNESS: I would agree with that.

MR. STEVENS: All right.

BY MR. STEVENS:

Q Now, with respect to the Act of March 20, 1986, as you have stated in there, it provides that implementation should not be later than 120 days after a hearing conducted in Section A. "The Secretary shall implement in accordance with the Agricultural Marketing Agreement ... a marketwide service payment program under Section 8c(5)(J) of such act ...", right?

A Yes.

Q Now, do you mean by this testimony that the Secretary shall implement an order with these provisions? And what I mean by that is, is it your testimony that, that the Congress has to have, in effect, order the Secretary to implement such a, such a plan?

A I haven't reviewed the congressional intent, so I can't answer that without looking at that. I will let us, respond to that in brief.

Q And certainly, certainly you can. The only point I am trying to get to is as I understand this, it depends on the record we are making here, and that the Secretary has the discretion as to whether to implement such a program based on the hearing record that we make here.

A I would, that would be the assumption, that was the assumption I had when I wrote that, but I haven't reviewed the congressional records, so, I don't --

~~Q~~ **A** It sounds reasonable to me.

Q So, not to say one way or the other, but certainly at the end of this hearing, and after all the, the Secretary will issue something and it may include such provisions or it may not based on the record.

A **I understand that.** Do you have any thought as to whether the 120 days after which the Secretary shall implement, the effective date of such an amendment or, or merely the issuance of the amendment?

A I would like it to be the implementation.

Q That is to say make it in effect.

A Yes.

MR. STEVENS: Thank you.

JUDGE BAKER: Very well. Mr. Rosenbaum?

BY MR. ROSENBAUM:

Q You testified previously that in order to qualify ~~the~~ **for** pooling under Order 1, that a, the supply plant be only shipped 20 percent of its milk to Class I handlers in September, October, November and 10 percent in August, and December, is that correct?

A During those months, unless it is changed by ~~administrative ---~~ **the Market Administrator.**

Q Yes. In terms of the current law.

A Yes, for those months.

Q But, in fact, I understand from your testimony that your cooperatives far in excess of those minimum requirements.

A Yes.

Q And, and based upon the utilization figures you have provided, there are many, many months in which rather than shipping more than the minimum requirements to meet the pooling requirements to a Class I plant, you have capacity available at your Dietrich's plants that is not used, correct?

A Yes.

Q Now, why is it that, and I assume that if you used more of the Dietrich's capacity, you would ~~low~~ **lower** the overall per pound output cost of that, of those two plants, right?

A Yes.

Q Now why is it that you decide not to ship that, in fact, why do you decide not to run that extra milk through your own plants, but instead to ship it to Class I handlers?

A We have fostered very good relationships with Class I customers and they rely upon us for a service that they need ~~---~~ , **giving them the** milk as they need **it** -- and so we have commitments to supply them with certain amounts of Class I milk, and we take it from where we can get it, when they need it, so, that they can always be assured to the extent that, to the extent possible, based on the supply situation, that they get the milk they need to meet their sales commitments. And so in doing that, it helps result in stronger Class I utilization, which improves the blend price, not just to our members, but all the participants under the order.

Q And, and, do you do economic calculations to decide that it is actually in your member's interest economically to ship in excess of the minimum **pooling** requirements to Class I handlers as opposed to using that milk in your unused capacity ~~and interest~~ **at Dietrich's**?

A It is not as easy as having a calculation on a particular day or a particular load, because it is more of a longer term relationship situation. We would refer to have more sales to Class I processors than we do because we think the relationships that that generates for the members of our organizations will result in stronger prices in the end to our members, then failing to meet their supply needs and having them look elsewhere for their milk supplies.

Q And ultimately, the determination of these issues is what is in the best economic interest of your members, I assume.

A The long term best interest. It is not on a short term day **to day** basis.

MR. ROSENBAUM: Thank you.

JUDGE BAKER: Very well. Thank you.

EXAMINATION BY MR. TOSI:

Q Can you explain a little further in the context of your testimony here, and I am asking about this in the context different than what Mr. English cross examined you on in relation the hauling charges that you related it to your position about things in Pennsylvania, with the Pennsylvania Milk Marketing Board. What exactly do you mean by hauling charges in the context of this testimony that you presented here on the marketwide services?

A Okay. On, on the, for Dairylea and DFA ~~--~~- , **just about everybody in the milkshed,** they have a fee that they charge farmers for picking up the milk and getting it delivered to a plant. So, on the business side that would be a hauling charge. On the, then the, so that would be a revenue to our position.

Then on the marketing end, Dairylea and DFA do not own trucks, so, we contract with milk haulers to provide that function for us, picking the milk up on the farm and delivering it ~~on~~ **to** the plants as we direct. And so, we have a cost to them and that also can be, in the table I use, that was the hauling charge -- Let me see if I can find it.

(Pause.)

THE WITNESS: On Table 1 where it says Central New York Hauling Costs, that is the actual charge we got from the milk hauling company that actually moved that load.

BY MR. TOSI:

Q Okay. So, in the context of your testimony here is that hauling is equivalent to a handling charge.

A Not exactly, no. I guess, because hauling charges are revenue --

~~Q~~ **A** On the producer side?

A Okay. ~~The revenue is a cost.~~ **You've got revenues and costs.** We ~~--~~ **sell a load of milk - -**

Q I guess I am talking about with respect to, it is a charge, a charge ~~--~~ **would be** you have got to pay somebody, so, I guess, in terms of a cost. Because you are wanting reimbursement for a service that your current cost support.

A Right. Okay, so, it is a cost to us when we pick the milk up and deliver it, and then we get some revenue for it, because we will assess the farmer for all or portion of that hauling cost. Does that make sense, the way I said it?

Q Yes, it does, but I just want to make sure that, we are using a lot of different terminology here.

A Okay.

Q On how we are carving up costs and assigning names to.

A Okay.

Q The types of costs and the only one that I just wasn't quite sure of, was handling. Handling charge, excuse me.

A Oh, okay.

Q Handling, did I say hauling?

A Yes.

Q I meant to say, I am sorry, I apologize. I meant to say handling charges.

A Okay. There is, in the context of what Mr. English talked about is a regulated premium and then there is a handling charge on top of that. And you add the two together and that is the price that someone in Pennsylvania Milk ~~Marketing~~, the customer ~~buys~~ **that** is regulated ~~---~~ **by the Pennsylvania Milk Marketing board** has to pay.

In the context of somebody who isn't, we call, whatever the total amount is that we charged them, a handling charge, so, you know, if in my discussion there was this much that is needed to cover the pay rolling, and all of that, that is part of the entire handling charge. Is that --

Q So, it would be like a premium?

A No, it would be the premium plus that handling charge, would be the entire handling charge is ~~when~~ **what** I refer to a handling charge.

Q Okay. Regarding the benefit that arises from the ~~--~~– **balancing function, you drew a parallel.** We all know as a country, we need defense spending, we need defense, and what is that worth, and the in the absence of being able to quantify the value of that, the only thing that we can go back to then to determine how much do you want to do this. We can only **look at** cost and --

A Yes.

Q -- and then draw a value judgement then.

A Yes.

Q -- for our values and in saying, well, is this something that is worth paying for or should we be paying this much or should we, should we spend more, should we spend less, that sort of thing.

A I would agree with that, yes, sir.

Q Okay. Are you, is your organization able to pay the blend price as published by the Market Administrator ~~--~~– **every month** to your members?

A I can answer that in two ways. Okay. -- if we didn't ~~--~~– **pay the quoted blend price, or show the quoted blend price on the milk check,** ~~if we didn't show the -- price,~~ we would probably lose a lot of ~~--~~– **producers.** What happens is ~~he has~~ **we've** got -- and blend price --

handling charges on top of that, which is everything, including whatever we have -- We have got we take from producers as revenue. And then we have our costs. And so, in the end there is a market price for milk and you know, you are aware of the blend prices no longer ~~--~~- **at market price.** When I first started in, out of college, in the Market Administrator's office, the blend price was the market price. Changes have been made to the system and now it is no longer. It is a minimal price we rely on for our premiums. So, the blend **plus the** premium, **that** is the market price.

For us to compete, we have got this pot of money, and ~~the only --~~- **we can only afford to pay out** what we have left after we pay our costs and the market price in the end that we can afford to pay out on average, is not as strong as the market price that is paid out by either method, producer, shippers and handlers. Now, I think the testimony of Travis Finn, yesterday, at least from farmers' knowledge, that they used to ship to DFA and they choose not to because they got more money elsewhere. We could not meet that ~~--~~- **competitive challenge.**

Q No, I, I, would it be correct in summarizing, what you just said is that when an independent producer is getting paid, he is getting something that perhaps, well, we know at a minimum, that the handlers is paid at least the blend, because the Order enforces that.

A Absolutely.

Q And the difference between handler and a cooperative member would be, well, it is just not as strong. Can I take to mean that the answer is yes, you are able to pay the blend?

A I talked about in my testimony here that there is a disorderly market condition because, because we have these balancing costs that are not coming out of the pool and are of value to everybody, that, really that costs forces us to pay, we result in getting less ~~in~~ **than** the blend. And I ~~was saying~~ **would say**, in our ~~---~~ **pay** program ~~---~~ **on our check, we bolster** the blend price to bring it up to the blend by using ~~, can come~~ **income** from other sources. So, I, I, it is a ~~schematics~~ **semantics** thing. I am saying there is an unequal situation because we have to do ~~---~~ **that and others don't.** Does that make sense the way I explained that?

Q I, I hear your answer. I am not going to make any value judgements right now.

Does Dairylea return to its membership what is commonly referred to as the 13th check?

A No.

Q Your footnote on page, hold on just a moment.

(Pause.)

BY MR. ~~FEUILLET~~ **TOSI**:

Q Your footnote on page six, should I interpret what you have written there that you are of the opinion that your sales to butter/powder plants are demand driven?

(Pause.)

BY MR. ~~FEUILLET~~ **TOSI**:

Q I guess the reason that I ask that is, is that, let me read. "Likely these manufacturing plants would not purchase milk if they didn't have a sale because of the high risk and cost of inventorying and hoping to develop a sale."

A Okay. To me, butter/powder plants that we sell to are Dietrich's, two Dietrich's plants and we force them to buy the milk from us. They don't have a choice. And that is what creates the losses that --

Q Okay.

A And if we didn't do that, we would have to either dump the milk, which you would get nothing and sell it to the next best return, and certainly ~~the -- testify~~ ,**we've already testified** that the Land 'O Lakes plant was ~~---~~ **farther, before we did ship milk** ~~shipment~~ as far west as Indiana, even with the balancing plants that we had, if

~~it closed~~ **those** two plants ~~for~~ **weren't in** operation, you know, we might have to go to California, just to get it somewhere. So, that is, it is a significant cost whether we have ~~---~~ **those plants or not.**

Q Make it clear for me, it may be clear for the record, but I, myself, I am still confused. Who, who owns the two plants that are presented in your --

A Right now, Dairy Farmers of America.

Q So, the Dietrich Family is no longer involved?

A That is correct. As owners.

Q As owners.

A Yes, that is correct.

Q Given that your organization doesn't directly own any plants, and to the extent that Proposal 7 seems to be found on the notion of ~~the~~ **unused** plant capacity, how do you relate the, what you are saying earlier, your costs to a study that bases costs on something that is different? I mean, there are no plant costs because Dairylea, for example, does not own the plants.

A Well, we, we, you are right, but, we incur the costs and losses of the Dietrich operation, because of the way that it is passed back to DMS and then distributed among the two member owners of DMS, **Dairylea, and DFA,** ~~--~~ ~~So~~ so that is part of the answer.

The other part I would refer to Mr. Wellington's testimony, I think is telling of the difference of balancing at cheese plant as opposed to a butter/powder plant. And he showed that the loss incurred of overhead by hauling a load of milk out of the cheese plant is something over a dollar, I don't know if it was a dollar **per hundredweight**, I can't remember the unit, as opposed to pulling it out of his butter/powder plant was 60, 61 cents per unit. So, as we do our system of balancing and ~~where~~ we don't balance **at** Dietrich's, we balance generally ~~---~~ **at** cheese plants, their risk costs is, is higher. Requires a higher return ~~---~~ **to purchase that milk**. So, I think our, in this study with Mr. Ling, in the most efficient system, I think it is shown that butter/powder processing is the most efficient system. And although we use our portfolio strategy, you know, we can do that because we don't enforce our members to invest in the plan. But, I, I am not sure that our portfolio strategy is the least cost method. I think and I know it is higher than the cost of showing Mr. Ling's study and I have highlighted those cost in that one table.

Q You indicated in your testimony that you were also market local, people who are, dairy farmers who are not members of DMS, Dairylea.

A   Yes, we do.

Q   Is that a significant ~~--~~- **volume?**

A   What is significant?

Q   Well, if you could say on an average basis what percent of the marketings, you claim five billion --

A   Could I answer it this way, because I don't want to divulge any confidentialities and I understand it is, you know, doesn't work because it is not on the record, but, through the Market Administrator reports we file, that could be identified, I ~~refer~~ **prefer**, if it could be identified that way, **than characterized** in front of our competition.

Q   Because it is, it is confidential because there is less than three producers?

A   No, it is ~~--~~- **not that simple.** I don't want to say something that may develop information that one of those customers would not like divulged, because it may result in somebody being able to figure out something about their operation that they would prefer to keep confidential.

Q   Okay. That is all right.

So, the fact that you do market the milk with non members, and to the extent that you claim that you are losing money, and in your plea for emergency action, saying that you will be forced to pay producers less than the blend price, aren't you required to pay the blend price to, for non members?

A We do.

Q So, where do you get this money, where does this money come from that you are losing? You are losing on behalf of your members, your testimony suggests that you can't pay the blend, okay. But, yet your marketing milk of non members and paying them the blend, I am confused by that.

A Well, we have to, we have to **pay** the blend price in the country to keep somebody that is shipped to us whether they are a Dairylea member, a DFA member or an independent producer **whose milk we market and pool,** ~~in the marketing pool~~, it says, the market price. We certainly pay the independent producers the blend price **as we are supposed to**. ~~--~~ We also have to pay them a premium in addition to that, to keep them shipping to us or they would find the market elsewhere that are paying market ~~--~~ – **,and that keeps their milk in the system to supply our customers.** ~~consistent by our customers.~~ We have balancing costs -- the market, including the independent producers that, -- We cannot charge the independent producers a special fee to get them to cover that portion ~~to pay what is~~ **that had** ~~being~~ ~~occurred~~ **been incurred on us**, our portion, the portion of every ~~paid members~~ **Dairylea and DFA member**. And if we reduce their premium to cover, they will look around and ship to somewhere else and we won't have their milk and we will be in ~~the~~ **a difficult** situation where we have to find milk to meet our commitments to the particular customers, whose producers we are marketing for them. So ~~-- our~~ ,**we're caught between a rock and a hard** place, and so, at the end what happens is the only ones in the end that can absorb that cost of balancing are the members of Dairylea and DFA.

Q Okay. I understand that is the theory, you have to be competitive out there and that is all that. What you are asking the Secretary to take emergency action in part because you are not able to pay the producers the blend price and the cooperatives and that has always been okay, I think, the cooperatives having ~~afforded the~~ **authority to re-** blend. And I am just wondering if you are losing money, how is it rational or where does the money come from that you are able to pay the blend on the milk that you are marketing for non members? I mean, it just seems to me the money has to come somewhere, and to the extent that that money is available to do that, I think one could conclude that whatever costs you are incurring are being offset or they are being paid for in some way by the people who are buying milk from you.

A ~~The~~ **Let me** answer ~~to that~~ **this** question **in this manner**, again, we get X amount of ~~--~~– **revenue** based on our sales of member milk and we base it on our sales of the independent producers.

~~--~~– **With your** calculation we have got the independent producers, we have to pay them X to keep them in balance. And then we have got the rest of the milk, keep them shipping to us. We have got the rest of the ~~revenue~~ **money** we have left over to pay our members. Before we can pay that out, we have to take our costs out. The costs are going to include our balancing costs. And so, on a hundredweight basis, in general. The member farms get a lower market price than the non member farms because they have didn't ~~occur~~ **incur** all of the balancing costs, all of the milk that DMS markets.

Q Well, okay, how is what you just said different from whether or not an independent producer makes money in saying, I milk cows, I deliver milk to the market, I get a price for that, that is my revenue and before I can tell you anything else, I subtract my costs? I mean, if he is not covering his costs, it is a different ~~-- before~~ ,**it**

won't be long that producer won't be able to do that.

A Correct.

Q And, and it would seem to me that in the context of treating cooperatives as a single entity dairy farmer, what is different there?

A The difference is the farms, the farms basically have the same costs and different based on their size. Whether they are a non member or they are all ~~---~~ part of a cooperative. The difference is that ~~---~~ **one producer** is **part of a** cooperative ~~---~~ ,**another is a non-member shipping milk to a cooperative.** ~~family producer, cooperative,~~ **That one producer** has more marketing costs that he is incurring, because he is doing the balancing of the milk than the one proprietary individual has because he is not operating a system that balances the milk, so he is not incurring that cost.

Q So, so, the reason somebody joins a co-op is to be able to incur more balancing cost because they are nice guys and they are concerned about balancing the Class I market.

A No, the reason why there is 4,000 ~~members~~ **independents**, the reason somebody would join a dairy cooperative is because in some places, you know, ~~the~~ **that's the only** market, other choices, again, in northern and western New York, a lot of the choices are only dairy cooperatives. The other reason is, I will use Dairylea as an example, Dairylea has set itself apart by developing **farm** service programs that will help members, will help members manage their costs and cash flow on the farm. Farms have joined us because we have this thing called "~~low~~ **milk** price stabilizer program", in which we will agree to pay them **the same blend price for a period of years**. At the end of the time program, adjust, so **that** they get whatever the actual average price was over that time period. And what it does, in the low price cycles, takes out all those low price cycles so they can better cash flow their operation and it is our contention that over a two, to three, to four year period, the average ~~low~~ **milk** price is pretty decent. And so, that they, they end getting the price they can live on and at the same time they are -- We can provide that type of service and there are farms that want that type of service as opposed to some other joint organization for that type of service, even, well, I will leave it at that.

Q I just want to throw a hypothetical at you here. Let's assume for example that your organization, DMS, is really good and they -- for sure. Let's assume that you are really big, great at marketing milk such that, this is, I want to exaggerate, just to make the point.

~~A~~ **Q** Okay.

Q Such that you are ~~equal~~ **able** to, within your market, within the Northeast market, and other markets where you have the ability to do this to work it out such that all of your sales end up going to Class I outlets.

A Okay.

Q Okay. And you have done that, you have made that decision, would you make that decision to do that if it meant that you are returning more money to the co-op and ergo to your members?

A We would make a decision to do that if we felt in the long term it was the best long term ~~---~~ **advantage.**

Q All right.

A Yes, that is fair.

Q So, now, let's bring us back then to a situation here where you own no plants, okay, yet you say you are incurring the costs of balancing when really aren't, aren't you, aren't what you doing is just directing **where** the milk of your producers happens to need to go that day?

A But, that is balancing. In the case of when milk ~~---~~ **is not needed in** Class I, we have to be the ones that identify whether there is a home that it can go to and get the milk landed there and take whatever return that we can. And we have to, to give examples of ~~the~~ **under** class pricing. You would say in the Class III price was 12, $11.00, and the ~~other~~ **under** class price was $2.00 under, so, we have got a return of $9.00. ~~---~~ **You have to account to the pool** at $11.00, so you would be out $2.00, we still have to pay the member the blend, which includes the $11.00 price, so we have a cost of $2.00 there.

Q Do you think it would be good policy for the Federal Order Program that the Secretary would have handlers charge producers for a service, that the handlers benefit from?

A I am not sure. I guess I would have to know, I would have to have an opportunity to look at the particular program and what was the cost benefit analysis to each.

Q Well, we are trying to figure out a value to benefit and we can't come up with one. We have to rely now on understanding that different groups incur different costs and, and because we can't really come up with a value, we have to come, a dollar figure, you know, cents per hundredweight or whatever. And we have to fall back to making a philosophical or a value of judgement about, you know, how do we make these things as ~~far~~ **fair** as we, as fair as we can.

A Okay. First of all, I would disagree with you in your suggestion that our proposal is handlers necessarily deducting ~~---~~ **money from producers.** We are doing the same pooling process as we do with Class I, in that the value of the pool is adjusted prior to the calculation ~~with~~ **of** the producer blend price, the same way ~~as~~ **that** the old ~~---~~ **cooperative payments** Program did that and the same way as the old Transportation ~~---~~ **credit under Order 2** did that, and in the same way that the Assembly Credit ~~Act was ---~~ **,to my knowledge assembly credits still happen in Order 30.** So, I, just schematics again, I differ with that.

Q Okay.

A Regarding what ~~our~~ **are** benefits. You know, we talked, I, I have testified to the relationship that we have with our Class I customers. We ~~come back and~~ **provide them a** service ~~with the long time continuous customers ---~~ **,and we want them to continue as customers, so we want to give them good service.** Let's take a hypothetical and say suppose we didn't, and suppose instead we made sure we got every gallon milk into the Middlebury Center and the Reading plant that we could and that, try to make that a profitable operation. And suppose that was that was going ~~out~~ **on** in November or, or October, sometime period in the fall and when it actually gets to the lowest amount of milk. There would be, so our Class I customers would not have the milk needs that they, that they would require. And they would have probably ~~-- and~~ **,along the line** have to cut back on some of their sale orders. Now, you can say, okay, let's quantify that **for a month**, because certainly by doing that, it results in Class I sales being lower, if I was in the pool, saying the Class I utilization being ~~--~~– **lower, the PPD declines** if our customers aren't able to meet the, the demands of their customers, the supermarkets, their customers are going to look for someone else. And it is, it is not out of the realm of possibility that someone else could be a plant ~~--~~ – **pooled in another order** to pick up some of that residual sales because they can't rely on their current customer. And it is not out of the realm of possibility, ~~-- sales,~~ **that those additional sales they pick up** aren't going to be enough to cause, say an Order 5 ~~--~~– **pool plant** to be pooled in Order 1. And so, those, those Class I sales are loss debit, not just for a part of a month or a month, but lost for good, from the order from the market that lowers that utilization. But, in doing what we are doing, by us keeping the Dietrich plants ~~emptying~~ **empty** in some cases or partially ~~emptying~~ **empty** most of the time, we are preventing that from happening. So, there, there, you could probably go through and make a calculation of the **under** capacity of all the plants that ADCNE operates, and say, what if we didn't supply Class I and their needs with that milk and what if we -- I am not saying, this is theoretical, you are asking me to do something ~~---~~ **theoretical.**

~~Q Theoretical.~~

A What is -- There is Class I's that have dropped out the market entirely. And there is a risk of that. There is also a benefit and again, I am not even sure, well, it was ~~alluded~~ **eluded** to **me** in the cross examination from Mr. Vetne, to some extent, if, if we, you know, another option, another option, if we didn't do what we did, some customers would go around the country and get their own producers or increase the number of producers, and if we knew -- give them the extra milk when they needed in the fall, they would go out and get more milk in the fall. And then in the spring, or the summertime, when they didn't ~~use~~ **need as** much, they would cut producers loose and that would create some, some other ~~chaos~~ **chaotic** marketing conditions. And when those producers were cut loose, they aren't going to just not ship their milk because there are costs ~~and ---~~ **that they need to cover** so, they need to get revenue. And they are going to land somewhere and when they land, they are likely going to land somewhere that very well undercut prices in the marketplace and cause prices to go down, which, which then would result in lower handler or premiums in the countryside -- I definitely believe that what we do in, by balancing operations, we help result in a higher producer price differential, ~~we~~ **would** create more favorable markets, so that guy from Fern Dairy can ship his milk to Furnace Point and Syracuse, every day, 365 days a year. And we supplies the system that results in more stable and higher premiums that would exist if we didn't do it. And those are all, you know, some of those things are, they are all kind of hired to calculate what the exact area would -- They are truly significant values of what we do in expending our money, in DMS' case, nine million dollars, this year, to balance the needs in the Class I market.

MR. TOSI: That is all that I have. Thank you very much.

JUDGE BAKER: Thank you. Yes, Mr. Beshore?

MR. BESHORE: Just a couple of questions on redirect, Mr. Gallagher.

REDIRECT EXAMINATION

BY MR. BESHORE:

Q Is there, in terms of why producers would join cooperatives as opposed to being independents in the market with all the obvious benefit we have heard about, and its **pay** prices, etc., are there unlimited number of slots available for independent producers in the market?

A No, no, there is, there is, what, well, there is **no** unlimited number of slots, that is right.

Q So, Class I handlers where ~~the~~ **those** producers predominantly supply, there are a certain number of slots and a certain amount of volume that they are prepared to contact ~~the~~ **for** independent shippers and that is a ~~determinative~~ **determined** in part of all producers' ability to fill those slots.

A Yes, sir.

Q Okay. Now, I want to make sure this is clear and I am afraid it has gotten confused today in the record and that is what the present prevailing pay prices are in the Northeast Marketing Order here with respect to **the** regulated minimum, so-called blend price, ~~for~~ **or** minimum PPD? And I want to, maybe we can clarify that by your reference to what price levels were when you started ~~in~~ **at** the MA's, the Market Administrator's Office, which was ~~20~~

how many years ago ~~-~~ **?**

A Yes. Starting at the MA's office in New York in 1984.

Q 1984. And I think your testimony is that at that time the prevailing pay prices were at or near the minimum blend, at Federal Order blend price.

A Yes, in the neighborhood of pretty much the Federal Order blend price -- if any premiums in the market ~~--~~-- **that were paid to producers.**

Q At that time, though, **there were** minimum, minimal premiums paid producers over minimum Federal Order blend price, correct?

A Yes.

Q And, in fact, there was some, what are so called -- **re-**blends from time to time by the cooperatives paid under -- two different instances of less than the ~~lower~~ **blend** prices.

A That is correct.

Q Okay. Now, is that the situation today in the Northeast market?

A No, it is not.

Q Can you give us a range, just to make us clear, is there a range, approximate prevailing over order pay prices to producers, cooperative or independent, you know, a range, so we have a feel for it?

A Depending on the size, a small farm would probably get something like 50 cent premium to a ~~--~~- **really large** farm now could probably get about **a buck** plus premium.

Q Those are the current, current market conditions in order to, are that over order payments to producers, the monthly check per hundredweight range from say 50 cents to more than a dollar.

A Yes, and, and we are not the ones that have set those higher end prices in the market place, we are responding to the market ~~place~~ **price**.

Q Okay. Your payment to your producers are competitive and they are within that range.

A They have to be or we wouldn’t be able to retain the milk supply.

Q Okay. So, that if you said anything or any of the agency and key witnesses said anything in this hearing that suggested that today you are not able to pay to your members the minimal blend price, that is, that is not the marketing conditions today, isn’t that correct?

A That is correct.

Q However, what are prevailing in the market conditions today, are that, the price you are able to pay is less than it would be otherwise because you are incurring all of the cost of balancing the market while all of the producers of the market are in an equal manner receiving the benefits of those services.

A Correct.

Q And partial reimbursement for that service is what Proposal 7 is about.

A Correct.

Q And by the way, it results in no, it requests no funds from Mr. Rosenbaum's clients, is that not correct?

A That is correct.

Q And the price stays the same, regardless, the same thing for Mr. English's clients, the minimum prices are exactly the same, correct?

A Correct.

Q It has nothing to do with what they are going to be charged under the Order.

A Correct.

MR. BESHORE: Thank you.

JUDGE BAKER: Thank you, Mr. Beshore.

Mr. Rosenbaum?

RECROSS EXAMINATION

BY MR. ROSENBAUM:

Q Mr. Gallagher, the amount that is drawn from the pool, is the blend price, correct?

A Sure.

Q And you are paying your members more than the blend price, correct?

A Yes, sir.

Q And you are doing so, notwithstanding the fact that according to your testimony, you were incurring losses and operating, the Dietrich Supply Plant, for example?

A That is correct.

Q And how is it that you are able to make up those losses such that the actual amount paid to your farmers is enough, not only to make up for those losses but to be paying your farmers in excess of the blend price?

A Again, the calculations, revenue **minus** cost and we get revenue in from our customers that instead of us being able to do that as premiums **to our members**, we have to use that absorb our balancing costs.

Q Well, and the money you get from your customers, you are describing over **order** premiums, is that right?

A Yes.

Q So, that the over order premiums you receive from your customers are sufficient, not only to make up for the balancing costs and losses you say you are suffering, but to make the actual pay price more than the minimum blend price, is that true?

A We pay more than the blend price ~~--~~- ,**but I wouldn't use the word "sufficient" to describe anything I say.**

Q And you may want more, I understand, but, from purely a mathematical perspective, the **amount of** over order premiums that you receive is enough to cover, to not only cover, let's start that again.

The amount of over order premiums you receive from your customers is enough both to cover your balancing costs, and to be able to pay your farmers more than the Federal blend price, isn't that true?

A They are getting more than the Federal blend price, but they are not getting as much as others are getting in the marketplace. And we would like to be able to have a special up charge to cover our balancing costs, that we would charge our customers, but, the fact of the matter is, that the marketplace doesn't allow us to charge that up charge.

MR. ROSENBAUM: That is all I have, Your Honor. Thank you.

JUDGE BAKER: Very well. Mr. Vetne?

RECROSS EXAMINATION

BY MR. VETNE:

Q Mr. Gallagher, in response to an earlier question from Mr. Rosenbaum, it was referring to milk that is received at the Dietrich's plants, and asked, as I recall, why that milk isn't going to the Class I plant. And I am not sure that I heard his question the same way you responded to it. There is a finite amount of milk that is used for Class I on any day or during any month, correct?

A Yes.

Q And that was the part of the graph of Dr. Ling, showing his ~~---~~ **fluid demand.**

A Yes.

Q And what goes to your Dietrich, or to the Dietrich plant or O-AT-KA, for that matter, that would be a marketing of last resort for you.

A We would like to be able to supply, even to the Dietrich plants, a consistent amount of milk, so that they can develop a stronger business, but we are not able to because we have to take milk out of there, to meet our Class I customers. At any time Dietrich has milk, it is generally because a Class I customer doesn't need it.

Q So, if on a day that Dietrich received milk from DMS, if, if you sent that milk to your Class I customer, you would simply be displacing other milk that is going to your Class I customer.

A Yes, sir.

Q Okay. And if you sent it to a plant that receives an independent supply, would displace some of their independent ~~supply~~ **supplied** milk.

A Yes, yes, sir.

Q And in any case, somewhere in the market, there would be milk flowing back into that reserve part or excess reserve part which was displaced by milk coming into the fluid in that part.

A Yes.

Q Would you agree with **me** that it is desirable also that the milk that comes into to meet fluid demand, comes from the most efficient location?

A Yes.

Q And that the Federal Order ~~goes~~ **rules** to the extent that they, that ~~often or~~ **ought** not, if at all possible, to require milk to come from a distance location, thereby, displacing more efficiently located milk.

A Correct.

Q Would it be correct to describe the location of the Dietrich **plants** as well as the O-AT-KA plants as being in the outer reaches of the supply area for the Metropolitan New York fluid market?

A O-AT-KA definitely is. Middlebury Center for the most place is, Reading is pretty close to ~~--~~ **the major supply area for the New York -** New Jersey metropolitan area.

MR. VETNE: All right, thank you.

JUDGE BAKER: Very well. Are there any additional questions? Yes, Mr. Tosi.

RECROSS EXAMINATION

BY MR. TOSI:

Q You don't have to go into a long answer, is there anywhere in your testimony that you could point me to that speaks to the revenue side of incurred costs, are these costs presented as, ~~cost~~ **net costs** after sales of product or --

A Yes, on the Dietrich, for example, you mean?

Q Yes.

A Net, go to Table 4, and this is, I took this off of the income statement **for Dietrich's** calculation. This is not -- But, you basically go through a pretty similar D&L and if you look at account label G that says DMS Recharge, and **the end** that is a charge assessed to Dairy Marketing Services that results in earnings before tax, basically is zero.

Q That recharge is --

A It will take into account -- A, we have got revenues, so that would take into account, you know, whatever Dietrich's was able to sell their product for.

Q Okay. And if you don't want to speak on behalf of the other witnesses here for Proposal 7, as you understood their costs, is there anything there where -- they made their product, sold their product, in that cost presentation, is there the revenue that incurs from the sales of butter and powder?

A I --

Q And if you don't feel comfortable --

A I don't feel comfortable to answer that question about their operations.

MR. TOSI: Okay. Thank you. That is all I have.

JUDGE BAKER: Thank you. Are there any other questions?

Very well. Thank you, Mr. Gallagher.

(Whereupon, the witness was excused.)

MR. BESHORE: I would like to move the admission of Exhibits 18 and 19 now.

JUDGE BAKER: Thank you. Are there any objections to Exhibits 18 and 19? There are none, Exhibits 18 and 19 are admitted and received into the record.

(The documents referred to,
having been previously marked
as Exhibit 18 and 19
were received in the record.)

JUDGE BAKER: Do we have another witness you want to examine?

MR. BESHORE: At some time before the hearing ~~and I had~~ **ends**, I would like to call Mr. Fredericks for one additional limited piece of information. It doesn't have to be at this time. He may have been asked to provide some other supplemental data by other participants and maybe we ought to catch that at one time. But, I just, I did want to note that, you know, at some point before we are done, I have one additional question.

JUDGE BAKER: Is Mr. ~~Frederick~~ **Fredericks** here right now?

MR. FREDERICK: Yes.

JUDGE BAKER: Would this not be a good time?

MR. ~~ROSENBAUM~~ **BESHORE**: That is fine.

JUDGE BAKER: We will try to break somewhere around 12:30 or quarter to one.

MR. ROSENBAUM: Your Honor, we have a witness who needs to make it back to Pennsylvania today and so, we would like to have him testify before lunch, if we could.

JUDGE BAKER: Very well.

MR. ROSENBAUM: I think that both of them would work out.

JUDGE BAKER: Very well. But, first I have heard --

MR. ROSENBAUM: I appreciate that.

JUDGE BAKER: Very well. Mr. Fredericks, would you -- No, no, no. Would you please not come forward right now, but a little later? Thank you.

And now Mr. Rosenbaum, who is your witness?

MR. ROSENBAUM: It is Bob Caplette, Your Honor.

JUDGE BAKER: Very well, thank you.

(Pause.)

Whereupon,

BOB CAPLETTE

having been first duly sworn, was called as witness herein and was examined and testified as follows:

DIRECT EXAMINATION

BY MR. ROSENBAUM:

Q Could you please state your name for the record?

A My name is Bob Caplette.

Q And Mr. Caplette have you come to testify today regarding the Proposal number 7?

A Yes.

Q And have you prepared a written statement?

A Yes, I have.

MR. ROSENBAUM: Your Honor, I have provided copies of the statement to the court reporter and to participants and I would ask that it be marked as Exhibit number 20 for identification.

JUDGE BAKER: Thank you.

(The document referred to was marked for identification as Exhibit 20.)

MR. ROSENBAUM: Mr. Caplette, if you would proceed, please.

TESTIMONY OF MR. CAPLETTE:

MR. CAPLETTE: Thank you.

My name is Bob Caplette. I am the plant accountant at the Readington Farms, Inc. I am responsible for all regulatory reporting, producer accounting and product flow analysis for the dairy. Prior to working at Readington Farms, I was a plant specialist for federal milk order number two, (New York, New Jersey), a senior auditor for federal milk marketing order 33, (Chicago region). I am testifying today in opposition of Proposal Number 7, which would add a provision to the Northeast

Order that would provide for marketwide service payments.

Readington Farms is a fluid milk processor located in Whitehouse, New Jersey. We process, package and distribute our products throughout a seven state area in the Northeastern United States. The company has been in existence since 1888.

Readington Farms pools approximately 35 million pounds of milk per month. The vast majority of our raw milk supply is obtained from our own independent dairy farmers with the remainder of our needs being obtained through balancing agreements, primarily with the area cooperatives.

The milk produced by our independent dairy farmers is handled by Readington Farms on a daily basis. This milk is delivered to the plant in Whitehouse and processed as a matter of routine. We have assumed responsibility for the purchase and disposition of this supply of milk for many years and would look to do so in the future.

The balancing agreements that we have with area cooperatives are basically designed to match the production requirements of the plant with the raw milk available. These agreements carry with them service charges and premiums that have been associated with the cost of providing the required balancing function. Thus, Readington Farms is already paying for the cost of balancing.

Proposal Number 7 would allow service payments of six cents per hundredweight to qualifying organizations, and would reduce the pay price to dairy farmers such as those independents that I mentioned earlier, to cover balancing costs that are not required by them. Readington Farms handles this function for these producers, thereby, taking this burden out of the pool.

In addition, the balancing agreements that Readington Farms has in place to match supply with demand are being paid by Readington Farms at market competitive rates. It would seem that adding a six cent charge is a duplication of payment for services rendered.

Finally, based on the proposal being considered at this hearing, there does not appear to be any language that identifies how this money would be used. No specific services of any kind would have to be provided to qualify for the payments. This lack of definition is troubling and is an additional reason why Readington Farms opposes Proposal Number 7.

JUDGE BAKER: Thank you, Mr. Caplette. Are there any questions of Mr. Caplette? Yes, Mr. Beshore?

CROSS EXAMINATION

BY MR. BESHORE:

Q Mr. Caplette, what products does Readington process at the Whitehouse plant or ~~as~~ a Class I operation, do you process any products other than Class I products?

A We do have other class usage.

Q And what other class usage do you have?

A Bulk sales.

Q So you buy and resell raw milk.

A No, we don't resell raw milk.

Q What product does are your bulk sales?

A Cream.

Q Pardon?

A Cream.

Q Cream. Okay. What is the Class I utilization of your plant?

A That is proprietary.

Q Do you, I take it from your testimony, that you utilize, that your independent dairy farmers, how many independent dairy farmers do you have?

A ~~I am not sure~~ **That is also proprietary**.

Q Where are they located?

A In Pennsylvania.

Q What distance, range of distance from their plant ~~and~~ **at** Whitehouse, New Jersey?

A I honestly don't know.

Q Do you process at Whitehouse all the

production, of all your independent producers?

A Yes.

Q Do you sell bulk sales of cream, is that the only bulk sale from your, from your Whitehouse plant?

A Yes.

Q What portion of your annual needs at Whitehouse are met by your own producers? What percentage?

A That is proprietary.

Q Do you purchase milk in the spring months from sources other than your own producers?

A Yes.

Q Do you purchase milk in the fall months from sources other than your own producers?

A Yes.

Q Are your purchases of milk in the fall greater than your purchases of milk in the spring, from outside sources?

A I, I specifically don't know. It is based on our sales, and on our needs.

Q Do your needs fluctuate from month to month for outside sales? Outside milk supplies?

A Not really. We, our monthly utilization is relatively steady.

Q Do your needs fluctuate from day to day, during the week, for outside milk supplies?

A   I personally don't know what our, our daily needs are. I am lucky enough to ~~---~~ **do the MA report**, so, all my stuff is a on monthly.   My knowledge is on a monthly basis.

Q   Do you know how many days a week your plant operates?

A   Yes. We take milk seven days a week.

Q   You take milk seven days a week. Do you package fluid milk products seven days a week?

A   No.

Q   How many days a week do you package fluid milk products?

A   It does vary, depending upon what is going on with our, our sources.

Q   Are you familiar with the price that you pay your independent dairy farmers?

A   Yes, I am.

Q   And what over order premium do you pay your independent dairy farmers?

A   That is proprietary, sir.

Q   Do you pay them an over order premium?

A   Yes.

Q   And you wouldn't have their milk if you didn't.

A   No, much like Mr. Gallagher said, we have to ~~make~~ **make, be** competitive to the farms.

Q Do you agree that in the Northeast Order that means premiums of the ranges that he indicated?
A Yes.
Q Now, from whom do you buy supplemental milk supplies for your plant?
A We would buy them from the co-ops in the Northeast.
Q Which co-ops do you purchase them from? More than one?
A Yes.
Q Okay. Which organizations?
A Well, we are a customer of DMS.
Q Are you a customer of any other?
A Yes, we do have other agreements with other co-ops.
Q And what cooperatives are they?
A Allied, Land 'O Lakes.
Q Okay. Do you purchase milk from Allied every month of the year?
A Yes.
Q Do you purchase milk from DMS every month of the year?
A Yes.
Q Do you purchase milk from Land 'O Lakes every month of the year?

A Yes.

Q Do you divert any of your producer milk to other locations?

A No.

Q How often do you pick up milk from your independent producers farms?

A Daily.

Q Every day.

A Every day.

Q Of every producer, every day?

A I am sure we have producers that are every other day. But, we bring in our own producers every day of the week.

Q You referred to having "balancing agreements" in your statement. What, what is a balancing agreement?

A We have agreements with our other milk suppliers, other than our independents, to supply our plant with the milk we need to ~~get~~ **meet** our orders. Above our independent producers.

Q What are the volumes that you purchase from your outside suppliers?

A Again, I don't do that, so I couldn't honestly tell you.

Q Do you know, okay, you are here to testify, you buy the balance of what you need from outside suppliers.

Do you know anything about the logistics of those supplies?

A I am not involved in that, like I said, our day to day operations is not where I am dealing with.

Q So, you wouldn't know whether or not --

A -- before.

Q You wouldn't know then whether those agreements allow you, allow your suppliers to plan say at the beginning of the month, for whatever volume you are going to need that month?

A I specifically do not know. I am not involved in that scheduling.

Q Okay. Can you offer us any information about what demands you make upon your suppliers with respect to tailoring their deliveries to your plant's needs in terms of, you know, for volumes, things of that nature?

A We do have at least one agreement of at least one load per ~~load~~ **day**. Other than that, I do not know.

Q Okay. So, one of the agreements with your supplemental suppliers, involves a committed supply of one load a day, every day of the year?

A Yes.

Q Is that the entire commitment from one of those suppliers?

A I don't believe so.

Q Beyond that, can you tell us anything about the **volume** expectations that you provide to your supplemental suppliers in advance?

A I, again, I am not party to that activity, so I really couldn't.

Q Are you party to the payment programs that you have or payment requirements for your supplemental supplies?

A Yes.

Q What do you pay for your supplemental supplies?

A It varies.

Q Okay. Does it vary on the basis of, well, on what basis does it vary?

A There are negotiated prices.

Q Are they a flat year **-round** prices?

A They do change. Again, I see that change in when I go through the final milk billings. So, I am not really even aware of it until give or take the 15**th** of the following month, we have price change.

Q So, you observe changes in prices but you do not know on what basis the price has changed, correct? Are the volumes different among those supplemental suppliers?

A Yes.

Q   Okay. Are the prices different among those three suppliers?

A   Yes.

Q   Is there any relationship of the prices to the volumes, to your knowledge?

A   Not to my knowledge.

Q   Is there any relationship of prices to the times and terms of delivery, to your knowledge?

A   Not that I am aware of.

Q   Is your independent milk supply ~~--~~- ,**I asked you how mant independent producers you had and you declined to answer.** Have you lost any independent dairy farmers in the past year?

A   Yes, we have.

Q   To cooperatives?

A   I assume that, but, I, I don't know.

Q   Do you know if they went out of business or just went somewhere else?

A   I would be willing to guess that --

Q   I don't want you to guess.

A   I don't have knowledge.

MR. BESHORE: Thank you, Mr. Caplette.

JUDGE BAKER: Very well. Thank you, Mr. Beshore.

Are there other questions for Mr. Caplette?

Yes, Mr. Arms.

MR. ARMS: David Arms for New York State Dairy Foods.

CROSS EXAMINATION

BY MR. ARMS:

Q Bob, for the benefit of the Department, people that are here, could you, give them and us some indication for the record, the scope of your operations? Would you classify Readington Farms as a small or large handler in this market?

A I really don't have knowledge of where we fit in the hierarchy.

Q Well, could you identify for the record where your prime production goes?

A It is --

Q In the stores, right?

A Metropolitan area, New York Metropolitan area.

Q No, I mean, can you identify the chain stores that you primarily serve?

A We are a wholly owned subsidiary of ~~--~~-

Wakeford.

Q And --

A Shop Rite.

Q Shop Rite stores.

A Yes, sir.

Q So, you are supplying all the product for the Shop Rite stores, isn't that -- Dairy products, at least in terms of milk.

A Yes, sir.

Q From amongst dairy suppliers, do you secure supply to brokerage firms that **in turn** balance for you?

A We also use a brokerage firm, yes.

Q One of the cooperatives that are, that furnish milk through that **milk** brokerage firm is the Middlebury Cooperative, is that true?

A We get a supply of milk from the Middlebury Coop.

MR. ARMS: Okay. Thank you.

JUDGE BAKER: Thank you. Are there any more questions of Mr. Caplette? Yes, Mr. Beshore?

FURTHER CROSS EXAMINATION

BY MR. BESHORE:

Q Just in response to the last question. Is that a **full** supplemental supplier or is that a subset of your independence or a subset of any of the other suppliers or --

A Middlebury is another co-op that we do get milk from. When I ran down the list, I, I did not mention them. It was not, it was an oversight.

Q What is your supply relationship with Middlebury?

A Basically the same as the rest of the co-ops.

Q Do you buy from Middlebury every month of the year?

A Yes.

Q Every week?

A I am not sure as to, again, the daily or weekly schedule. I really can't say.

Q --- **Level** volumes throughout the year?

A Relatively.

Q Is the price the same as the other suppliers?

A It is a negotiated price, yes, sir.

Q Price level the same, price terms the same?

A Again, all part of the negotiation, yes.

Q Who negotiates, you don't negotiate the contracts?

A No.

MR. BESHORE: Thank you.

JUDGE BAKER: Thank you. Are there any additional questions? Yes, sir?

MR. SHINBECK: I have just a couple of questions. My name is Martin Shinbeck. I am the CEO of Friendship Dairies.

BY MR. SHINBECK:

Q Mr. Caplette, have you heard of the term "handling charges" as it pertains to the purchase price for milk?

A Yes, I have.

Q Are you aware of various levels of handling charges based perhaps on various levels of service that the selling organization provides on the sales of this milk?

A Generally ~~---~~ **speaking yes.**

Q Is it possible that one of these services is a charge for balancing?

A I suppose that is possible.

Q And would you define balancing for me, please, as you understand it?

A Balancing for our plant is the, for the milk requirements, that we need to supply our stores above that, which our independent producers do.

Q Okay. And are you aware of your organization paying as part of your, the handling charges, that you pay, if you so pay a handling charge, are you aware of a charge in your component of the handling charge for balancing your supply?

A On the milk invoices that I see, there intends to be a lump sum, a set amount. It is not normally broken out.

Q And do you have any knowledge from the person who negotiates the charges for such milk of the component balancing being included as part of the price that your organization pays?

A Again, I am not party to that. These are negotiated rates that in both business would have to go to cover costs.

Q Okay. And **not** having personal knowledge, is it possible in your opinion for such a charge to be part of the total balancing cost, the handling costs that you are paying?

A It is possible.

MR. SHINBECK Thank you, sir.

JUDGE BAKER: Thank you. Are there other questions. Yes, Mr. Tosi?

CROSS EXAMINATION

BY MR. TOSI:

Q Thank you for appearing, Mr. Caplette.

Your plant at Whitehouse, New Jersey, do you employ fewer than 500 employees?

A Yes.

Q Do you receive any income from entities that ask you to pool additional milk on the report that you submit to the Market Administrator?

A Could you repeat the question?

Q Yes. Do you receive any income by reporting milk on your monthly report to the Market Administrator that you don't typically receive?

A I am sorry, I am really not sure what you are asking.

Q Do you divert milk?

A We do not.

Q That answers the question.

A Okay.

Q I obviously should have started with that.

For the price that you, from the price that you pay, I am not going to ask you for specific amount or anything like that, I just want to understand conceptionally the sorts of things that you consider.

To the extent that when you are buying milk from cooperatives, they actually indicate to you, to your agreements, that this is cost of milk, this is the service charge, this is the balancing charge, things of that nature? I mean, are they specific?

A It is not that specific.

Q What, what leads you to the conclusion that you are being charged a balancing fee?

A Again, those are negotiated rates. That is what it costs, is going to cost us to get that milk to our plant. The, the business assumption is they are **not** going to get milk to our plant ~~---~~ **at a loss.**

Q To spite testimony that indicate that, in fact, you have --

A Again, this is kind of ~~---~~ **my simplistic** understanding of things. A working relationship with these organizations. These were negotiated rates. I am kind of at the bottom line of that, just approving the bill type of thing.

MR. TOSI: I would like to withdraw that question, Your Honor. I did not mean to put words in the witness' mouth.

JUDGE BAKER: Very well.

MR. TOSI: I apologize.

BY MR. TOSI:

Q To the extent that you are charged something from the cooperatives for the milk that you need to buy, and when you compare that to what it is that you are able to pay your own independent producers, does the notion that you are paying something more than the Federal order minimum enter into the notion, enter into your thoughts and calculations on what it is that you would have to pay them to be competitive with the cooperative?

A Are you referring to --

Q Let me try to restructure that question.

When you buy milk from cooperatives, I believe your testimony is saying that, that your agreements arrive at a price and you believe that there are things included in there called service charges and premiums and things that have been associated with the cost of providing balancing.

A Yes, sir.

Q Okay. But, it is not an explicit charge.

A No, the language that I see does not have that detailed breakdown.

Q Okay. And your conclusion then that it probably does include balancing, would stem from the fact that if it didn't, they probably wouldn't supply it to you at that price.

A At that price.

MR. TOSI: That is all I have, thank you.

JUDGE BAKER: Thank you. Are there any other questions for Mr. Caplette?

There are none. Thank you very much, Mr. Caplette.

(Whereupon, the witness was excused.)

MR. ROSENBAUM: Your Honor, I would ask the Exhibit 20 be admitted into evidence.

JUDGE BAKER: Are there any questions or

objections? Hearing none, Exhibit 20 is admitted and received into evidence.

(The document referred to,
having been previously marked
as Exhibit 20
was received in evidence.)

JUDGE BAKER: That brings us to a time for our luncheon recess. We will take an hour for luncheon recess.

(Whereupon, at 12:45 p.m., the hearing was recessed, to reconvene at 1:45 p.m., this same day, Thursday, September 12, 2002.)

A F T E R N O O N   S E S S I O N

JUDGE BAKER: Thank you for being so prompt.

Is there anyone else who has any testimony or otherwise wishes to offer any comments with respect to Proposal 7, other than Mr. Fredericks? Yes?

MR. ROSENBAUM: Yes, Your Honor, there are a number of witnesses still on Proposal 7.

JUDGE BAKER: Oh, there are?

MR. ROSENBAUM: Yes, Your Honor.

JUDGE BAKER: Thank you. I am trying to get a feel for this and how much more we have to go over.

MR. ~~BESHORE~~ **ROSENBAUM**: I have five.

JUDGE BAKER: You have five. Five. Oh, very well. I figure we still have a long ways to go on Proposal 7.

Mr. Beshore, let me ask you, are you through with your presentation?

MR. BESHORE: But, for Mr. Fredericks.

JUDGE BAKER: But, for Mr. Fredericks. Do you want him to testify now?

MR. BESHORE: I am really indifferent. He is going to be here, so now is as good as any for me, but, it is, that is subject to everyone’s convenience.

JUDGE BAKER: All right. Well, maybe it would be a good time, he is here and --

MR. BESHORE: Well, he is going to be here, you know, for the whole time, so.

JUDGE BAKER: Well, perhaps this would be a good time.

MR. BESHORE: Sure.

(Pause.)

MR. BESHORE: Your Honor?

JUDGE BAKER: Yes.

MR. BESHORE: Some of what Mr. Fredericks has is particular interest to Mr. Vetne, who is not here for the time being at the hearing. So, it would, for that reason it would probably be in all our interest to defer Mr. Fredericks, you know, until later.

JUDGE BAKER: Right, we will defer that then.

Then, Mr. Rosenbaum, you are going to call your witnesses, is that right?

MR. ROSENBAUM: Yes, Your Honor. I could.

JUDGE BAKER: Thank you.

MR. ROSENBAUM: Your Honor, we call Dr. Robert Yonkers.

JUDGE BAKER: Thank you.

(Pause.)

Whereupon,

DR. ROBERT YONKERS

having been first duly sworn, was called as witness herein and was examined and testified as follows:

JUDGE BAKER: Would you be seated, please?

(Pause.)

MR. ROSENBAUM: Your Honor, we have three documents that we would like to have marked separately as exhibits.

JUDGE BAKER: Very well.

MR. ROSENBAUM: We would like, the first one is the larger document, entitled "Testimony of the International Dairymen Association September 2002, Federal Milk Order Hearings. We would like to have that marked for identification as Exhibit 21.

JUDGE BAKER: Very well. It shall be so marked.

(The document referred to was marked for identification as Exhibit 21.)

MR. ROSENBAUM: The next document is called, entitled "Chart 1, Seasonality of Milk Production in the United States, Selected 3 Year Periods." We would ask that that be marked as Exhibit 22.

JUDGE BAKER: Very well. It will be so marked.

(The document referred to

Was marked for identification
as Exhibit 22.)

MR. ROSENBAUM: And then the third document entitled “Chart 2, Seasonality of Milk Production in the Three Northeast States Which USDA Reports Monthly Data(NY, PA, VT), Selected Years.” And we would ask that that be marked as Exhibit 23.

JUDGE BAKER: Very well. Thank you. It will be so marked.

(The document referred to
was marked for identification
as Exhibit 23.)

MR. ROSENBAUM: Dr. Yonkers?

TESTIMONY OF DR. ROBERT YONKERS:

DR. YONKERS: Yes, my name is Robert Yonkers, R-O-B-E-R-T, Y-O-N-K-E-R-S.

Good afternoon. This testimony is submitted on behalf of the International Dairy Foods Association, its constituent groups, and their members. IDFA is trade association representing processors, manufacturers, marketers, distributors, and ~~supplies~~ **suppliers** of dairy foods, including milk, cheese, ice cream and frozen desserts. IDFA serves as an umbrella organization for three constituent groups: the Milk Industry Foundation or “MIF”, the National Cheese Institute or “NCI”, and the

International Ice Cream Association or “IICA”, which together represents about 85 percent of all the dairy product processing in this 70 billion dollar U.S. dairy food industry. MIF has over a 110 member companies that process and market about 90 percent of the fluid milk and the fluid milk products consumed nationwide; NCI has over 70 member companies that manufacture, process and market more than 85 percent of the cheese consumed in the U.S.; and IICA has over 80 member companies that manufacture, market and distribute an estimated 85 percent of the ice cream and ice cream related products consumed in the United States.

As buyers and processors of milk, the members of IDFA and its constituent organizations have a critical interest in this hearing. Most of the milk bought and handled by IDFA members is purchased under the Federal milk marketing orders promulgated pursuant to the Agricultural Marketing Agreement Act of 1937, (the “AMAA”).

I am Dr. Robert D. Yonkers, Chief Economist and Director of Policy Analysis at IDFA. I have held that position since June 1998. I hold a Ph.D. in Agricultural Economics from Texas A&M University in 1989; a Master Degree in Dairy Science from Texas A&M in 1981; and a Bachelor of Science Degree in Dairy Production from Kansas

State University in 1979. I have been a member of the American Agricultural Economics Association since 1984.

Prior to taking my current position at IFDA, I was a tenured faculty member in the Department of Agricultural Economics and Rural Sociology at The Pennsylvania State University, where I was employed for nine years. At Penn State, I conducted research on the impacts of changing market conditions, alternative public policies, and emerging technologies on the dairy industry. In addition, I have statewide responsibilities to develop and deliver extension materials and programs on topics related to dairy marketing and policy. I have written and spoken on extensively on economic issues related to the dairy industry, and have prepared and delivered expert witness testimony to state legislatures and to Congress.

MR. ROSENBAUM: Your Honor, at this time I would ask that Dr. Yonkers be designated as an expert as an agricultural economist and as a dairy economist.

JUDGE BAKER: Are there any questions, objections, voir dire, with respect to that request? Let the record reflect that there are none. And Dr. Yonkers is declared an expert as an agricultural economist and a dairy economist.

DR. YONKERS: Thank you, Your Honor.

JUDGE BAKER: You are welcome.

DR. YONKERS: This hearing was called to consider a number of proposals that would amend certain provisions of the Northeast order. My testimony will address one of those provisions, Number 7, one of those proposals, Number 7, which would establish so-called marketwide service payments.

IDFA and its constitute groups strenuously oppose this proposal and urge USDA to reject it. IDFA's opposition is based on the following reasons:

1. Over the last 40 years, USDA has on a number of occasions denied proposals to amend federal orders to provide for marketwide service payments. USDA did so most recently in 1999, with respect to a proposal advanced for the Northeast order that is very similar to the one at issue in these hearings. There have been no changes in dairy industry market conditions that would justify a different result now.

2. In their March 8, 2002 letter of USDA requesting this hearing, the proponents of Proposal number 7 stated that marketwide service payments are needed in order to "provide reimbursements" for their "balancing activities". The proponents have confirmed

in their testimony that this is the sole justification they advance for their proposal. But even if balancing presented an issue that needs to be addressed through the federal order program, it has already been addressed. Based upon the testimony and proposals of the cooperatives, themselves, USDA set a Class IV make allowance that is high enough to allow Class IV plants to cover 100 percent of their costs, including all costs of balancing. Indeed, when USDA set the make allowances for these products, it explicitly stated that it was setting a make allowance high enough to pay the costs incurred by balancing plants. Proposal Number 7 thus constitutes an effort to be paid twice for the same thing.

3. Even if, contrary to fact, there were somehow a need to provide even more funds to cover the cost of balancing, these costs are more than amply covered by over order premiums that are already being paid to Class IV handlers in the Northeast order. Whenever a Class IV handler provides milk to a Class I handler in lieu of processing that

milk in its own plant, the Class IV handler receives an over order premium from the Class I handler. Put another way, if, as the proponents claim, they incur cost when their plants run at less then full capacity in order to meet the needs of the Class I market, those costs are already more than covered by the extra money they receive via Class I over order premiums.

4. A principal justification advanced for marketwide service payments is the purported costs of balancing the market due to seasonality in milk production. But, the seasonality of milk production has declined precipitously for many years, and continues to do so. Marketwide service payments is a concept whose time came and went decades ago and even then rested on rickety legs.

5. Proposal Number 7 is hopelessly flawed. Large cooperatives would qualify for payments without performing any marketwide benefits, whatsoever. Small handlers would not quality for payments regardless of the balancing they perform. In these respects, the proposal is a direct violation of AMAA requirements.

Moreover, the significant flow of milk into and out of the Northeast order would result in Northeast producers making marketwide service payments when the balancing services were being provided to producers located in other orders. That is the very defect that led USDA to reject marketwide service payments when they were considered for the Southeast orders.

6. Finally, in light of the fact that no rationale exists for marketwide service payments in the first place, there is obviously no emergency that could warrant the omission of a recommended decision. Instead, the proposal should be rejected in its entirety.

I. USDA Has Frequently Rejected Proposals For Marketwide Service Payments Over the Last Forty Years.

I will briefly recount past USDA decisions to reject marketwide service payments proposals, and then apply the reasoning that underlies USDA's past decisions to show why Proposal Number 7 suffers from the same defects as did these previous proposals.

The 1940s through 1985. At the end of the 1940s, four of the 39 federal orders then in existence contained provisions providing for marketwide service payments, but the Boston order provision was declared unlawful by the United States Supreme Court in 1952. Following that court decision, USDA removed similar provisions in the Cincinnati and Dayton-Springfield orders. That left New York as the only order providing for such payments. In the case of New York, marketwide service payments could be earned, but only for services that were clearly laid out in the order provision, and for which qualifying entities had to submit detailed reports to the Market Administrator in order to receive any payments.

Cooperatives on a number of occasions attempted to persuade USDA to adopt marketwide service payments in other orders, or at least to hold hearings to consider them. But USDA always rejected those proposals.

This history was recounted in detail by Herbert L. Forest, who began working at the Dairy Division in 1935, before the AMAA was even enacted, and served as Director of the Dairy Division of USDA for 30 years, from 1952 through 1982. As Mr. Forest stated:

The Department has always taken a strong position against any proposal that involved deductions from dairy farmers through pool deductions. Until recently, there was always a strong legal basis for this position because of the Stark case, which ruled that deductions from the pool in the Boston Market for marketwide service payments were illegal. But, even more than the legal basis, our position was based on a more basic premise -- and that was that the people who got the benefit of the services should be the ones who should pay for them. I still feel strongly that this is the way it should be. If a chain store operating its own bottling plant wants specific quantities of milk on only four or five days, then they should pay for that kind of service. The cost of operating its plant is lower than the handler who receives all the milk from its dairy farmers seven days a week. Likewise, if a dairy farmer wants to be guaranteed a market for all his milk seven days a week, he can get it through his cooperative. And he should expect to pay for that guarantee. There is no obligation under the orders that requires a cooperative to perform any services for free.

The orders recognize the need for cooperatives to be paid for services performed by setting only a minimum price. The Act provides for co-ops to charge farmers under contract for services performed for them. For the most part, if a service is sought by the buyer, the buyer should pay for it. If the buyer doesn’t want the service, the question arises as to who the beneficiary is. If it is for the cooperative members, they should pay for it. It is very difficult to identify services performed by cooperatives for which the beneficiary is not the buyer of their milk or the members of the cooperative. (Sworn Testimony of Herbert L. Forest, Hearings to Consider Payments Under Seven Southeastern Orders For Marketwide Service Payments, Docket Numbers AO-366-A28, et.al, September 8, 1986.)

1985 through 1998. After the 1985 Farm Bill amended the AMAA explicitly to authorize payment to handlers for “services of the marketwide benefit”, a proposal was advanced to add payments to the seven Southeastern orders then in existence. But, after extensive hearings, which lasted for 10 days, involved 41 witnesses and 122 exhibits, and produced 2951 pages of transcript, USDA concluded that “the record evidence does not demonstrate the proposed marketwide service provisions would effectuate the purposes of the Agricultural Marketing Agreement Act of 1937, as amended.” Milk in t he Georgia, and Certain Other Marketing Areas, Docket Numbers AO-366-A28, et al., Federal Register, Volume 52, Page 15951, May 1, 1987. That decision brought to an end proposals that had been bandied about to add marketwide service payment provisions in other orders as well. Later, I will discuss in more detail the reason why USDA rejected the Southeastern orders proposal, and the implications of that reasoning for the proposal at issue at these hearings.

1998-2002. The 1996 FAIR Act mandated the consolidation of existing orders into a smaller number of geographically larger orders. This meant that the New York-New Jersey order - the only one in the country that had a marketwide service payment provision - would be consolidated with two orders that did not (the New England and Atlantic orders). The question was thus presented - would the consolidated Northeast order have a marketwide service payment as had the New York-New Jersey order, or exclude such payments as they had been excluded from the other two orders that were merged? The quantity of milk pooled on those two orders combined slightly exceeded the quantity pooled on the New York-New Jersey order.

ADCNE, the proponents of the current Proposal number 7, submitted a proposal to USDA in 1997 to adopt a marketwide service payment provision in the merged Northeast order. As with Proposal Number 7, ADCNE sought a payment of six cents per hundredweight (comprised of two cents for cooperative service payments and four cents for purported balancing payments).

USDA rejected that proposal in its proposed rule published in January of 1998, finding, among other things, that (1) two of the three orders merged into the Northeast order had no such provisions prior to order reform, and had no evidence of harm or disadvantage arising from the lack of them; and (2) a separate Class IV milk price provides handlers with a market clearing price, and further compensation beyond this **is** not warranted. Federal Register, Volume 63, Pages 4,951 through 4,952, January 30, 1998.

After USDA published this proposed rule rejecting any marketwide service payment provisions, ADCNE modified its proposal, this time proposing a six cent per hundredweight payment solely for purported balancing services. USDA again rejected this proposal, again noting among things that (1) two of the three orders merged into the Northeast order had no such provisions prior to order reform and had no evidence of harm or disadvantage arising from the lack of them; and (2) a separate Class IV milk price provides handlers with a market clearing price, and further compensation beyond this is not warranted. Federal Register, Volume 64, Pages 16146 through 16148, April 2, 1999.

All of this history makes perfectly clear that USDA rejected marketwide service payment for the Northeast, as recently as in 1999, with respect to a very similar proposal, submitted by the very same group that has put forth Proposal Number 7. IDFA submits that these proponents carry a very heavy burden of proving that marketwide service payment in the Northeast, which previously had made no sense to USDA, are suddenly somehow a good idea.

In fact, the purported justifications for such payments have only grown weaker.

II. BALANCING COSTS ARE ALREADY PAID FOR THROUGH THE MAKE ALLOWANCE.

The costs of balancing are already fully paid for through the made allowance on Class IV products. USDA explicitly set the make allowance for these products at a level sufficient to enable Class IV processors to cover their balancing costs. Proposal Number 7 thus constitutes an effort to be paid twice for the same thing.

In making this point, I am simply elaborating upon the conclusion that has already been reached by USDA, not once, but twice. When USDA in its 1998 proposed rule rejected ADCNE's proposal for marketwide service payment, it made the following statement, which I wholeheartedly endorse:

> "In addition to expressed opposition to compensate handlers for balancing the market, an appropriate class price has been provided for market clearing purposes -- the Class

III--A price. It is a price that is applicable in all current Northeast orders, and is continued in this proposed rule as the Class IV price. While these two class prices are not the same (as explained in the BFP section of this decision), they are conceptually similar in that handlers have been provided with a market clearing price and further compensation beyond this is not warranted. Federal Register, Volume 63, Pages 4951 through 4952, January 30, 1998."

as I have noted previously, ADCNE responded to this proposed rule with an amended marketwide service payment proposal, which USDA also rejected in the 1999 final rule. In so doing, USDA again made a similar observation:

"The proposed rule also indicated that balancing payments should not be adopted because an appropriate class price has been provided for market clearing purposes -- the Class IIIA price. It is a price that is applicable in all current Northeast orders, and is continued in this decision as the Class IV price. While these two class prices are not the same, (as explained in the BFP section of this decision) they are conceptually similar in that handlers **have been provided** with a market clearing price and further compensation beyond this does not appear to be warranted." Federal Register, Volume 64 Page 16148, April 3, 1999.

In both of these decisions, USDA correctly concluded that Class IV, or Class IIIA prior to order reform, provides the mechanism under federal order regulation to clear the market, and in so doing, covers balancing costs.

Moreover, and of great significance, USDA subsequently and explicitly, set the make allowance at the level sufficiently high to cover all balancing costs incurred by Class IV butter and powder plants.

Under the order system in place since January 1, 2000, the minimum Class IV milk price for butter and for nonfat dry milk equals the actual finished product price as determined by monthly survey, minus the make allowance. Thus, the make allowance equals the actual finished ~~produce~~ **product** price minus the minimum milk price established by regulation.

The make allowance is set at a level designed to cover all costs of owning and operating a plant that processes milk into the two Class IV products. This includes both fixed cost, such as the cost of building the plant, which is accounted for through a charge for depreciation, and variable costs, electricity, labor, packaging, etc., as well as marketing expenses and a return on investment.

The make allowances currently in place were set as a result of the Class III and IV formula hearings held in May of 2000. Although IDFA testified extensively at those hearings regarding the proper make allowance for Class III products, cheese, it does not represent butter and nonfat dry milk producers and accordingly did not itself address the proper make allowance for those products. Rather, the proper make allowance for Class IV products was established through the proposals and testimony of the cooperative processors, who produce about 70 percent of these products, and their associations.

The cooperatives presented ~~date~~ **data** from two surveys to determine the proper make allowance -- one survey that had been conducted by USDA's Rural Business Cooperative Service and one by the California Department of Food and Agriculture. The CDFA data came directly from the audits of the trained CDFA auditors routinely perform in California butter power plants, and which CDFA then publishes.

Based upon this data, USDA in its December 2000 tentative final decision adopted an 11.5 cent make allowance for butter and a 14.0 cent make allowance for nonfat dry milk. These make allowances came into effect January 1, 2001, and are the make allowances now in place. (USDA's subsequent recommended decision, which when finalized will implement make allowances on a permanent basis, proposes to leave unchanged the make allowance for both butter and nonfat dry milk that were established in the tentative final decision. Federal Register, Volume 66, Pages 54064 through 54096, October 25, 2001.

In setting these make allowances for butter and nonfat dry milk, USDA explicitly stated that it was establishing make allowances at a level high enough to cover all the costs incurred by a balancing plant, the very costs that ADCNE seeks to have paid -- for a second time -- through Proposal number 7. USDA ~~states~~ **stated** as follows:

> "Make Allowance, (butter). The make allowance factor in the Class IV butterfat formula should be derived from a combination of the manufacturing costs determined by the California Department of Food and Agriculture and by USDA's Rural Business Cooperative Service, as they were in the

final decision. The CDFA cost data is divided into two groups representing high cost and low cost butter plants, with the four plants in the high cost group manufacturing, on average, about the same average number of pounds of butter as the seven plants in the RBCS study. Use the data for the California high cost group of butter plants is more appropriate than use of the weighted average cost for all of the CDFA plants because it is more likely that the high cost plants, like the plants in the RBCS survey, serve a predominantly balancing function.

When the RBCS data is adjusted to reflect the same packaging cost, general and administrative costs, and return on investment as the CDFA data for the high cost group, and the marketing allowance of $0.0015 is added to both sets of data, the weighted average of the two data sets is $0.115. This butter manufacturing allowance is very close to the current allowance of $0.114, and should continue to provide a representative level of the costs of making butter in plants that serve a balancing function." Federal Register, Volume 65, Page 76842, December 7, 2000.

Thus, USDA intentionally set a make allowance for butter that is high enough to cover balancing costs. And USDA also did the same with respect to nonfat dry milk:

"On the basis of the data and testimony included in the hearing record, the manufacturing cost level that appears to be the most appropriate for use in the pricing formula for nonfat solids is $0.14. This value is calculated by using a weighted average of the RBCS survey and the two less cost California groups of plants, adding the California General and Administrative costs and Return on Investment expenses for those two groups to the RBCS numbers, and a $0.0015 marketing allowance to both sets of data. The basis for using the two lower cost groups of California plants are that the mid cost group is of a similar average size as the group included in the RBCS survey, and that the lowest cost California group has a very similar total cost to the mid cost group. These three groups of plants (the RBCS plants and the two California groups) are similar enough in size and cost to consider as fairly representative, and should encompass those plants that perform a market balancing function." Federal Register, Volume 65, Page 76843, December 7, 2000.

I will have to leave it to the proponents to try to explain why they are entitled to marketwide service payment to cover the costs of balancing, when USDA in year 2000 and year 2001 purposely set the make allowances high enough so that they would fully recover those costs through the make allowances.

It is important to note that the cooperatives were given a full opportunity to respond to USDA's statements in the tentative final decision that it had purposely set the make allowance so as to cover the costs of those plants that perform a market balancing function. The tentative final decision, from which I have just quoted, was issued in December 7, 2000, in order to meet the congressional mandate that the new make allowances go into effect by January 1, 2001. But, parties were given the opportunity to submit comments on the tentative final decision and to suggest changes that should be made.

As best as IDFA can determine, not a single cooperative or farmer organization challenged USDA's statement that the butter and nonfat dry milk make allowances had been set to reflect the costs incurred by plants that provide balancing functions. To the contrary, the National Milk Producers Federation submitted comments on January 31, 2001 stating that it “supports the decision with one exception”, and that exception did not relate to make allowances. ADCNE, itself, submitted comments on February 9, 2001, and under the heading “ADCNE Comments Upon the Make Allowances Adopted for Class III and IV, stated as follows:

“In determining the appropriate make allowances for Class III and Class IV prices, ADCNE suggested that the Department should use all credible, reliable information available to it, and we believe the Department did so and commend the decision in that regard.”

ADCNE’s written submission went on to comment on two aspects of the Class III, cheese, make allowances, but said nothing more on the Class IV, butter and nonfat dry milk, make allowance.

The absence of criticism is reflected in the recommended decision that USDA published on October 25, 2001, which suggested certain changes in the formulas adopted in the tentative final decision, but no changes to the Class IV make allowances. In that recommended decision, USDA stated: “No comments were filed that specifically addresses the adopted make allowance for use in the nonfat solids price." Federal Register, Volume 66, Page 54078. And USDA's discussion in the recommended decision of the butter make allowance does not reflect that any comments were filed as to make allowance either.

To the contrary, USDA in the recommended decision repeated virtually verbatim the conclusions it had reached in the tentative final decision regarding the fact that the make allowances had been set so as to encompass the costs of balancing. It did so with respect to the butter make allowance:

> "Use of the data for the CDFA high-cost group plants is more appropriate than use of the weighted average cost for all of the California plants because it is more likely that the high-cost plants, like the plants in the RBCS survey, serve a predominantly balancing function....This butter manufacturing allowance is very close to the current allowance of $0.114, and should continue to provide a representative level of the costs of making butter in plants that serve a balancing function." Federal Register, Volume 66, Page 54077, October 25, 2001.

And USDA did so with respect to nonfat dry milk as well: “These three groups of plants (the RBCS plants and the two California groups) are similar enough in size and cost to consider as fairly representative, and should encompass those plants that
perform a market balancing function.” Federal Register, Volume 66, Page 54078, October 25, 2001.

Further confirmation that the make allowance already covers balancing costs can be derived from the study by Dr. Ling that the proponents rely upon in their proposal--”Cost of Balancing Milk Supplies: Northeast Regional Market,” published by RBCS(Report 188). Although I do not, for reasons I will discuss later, agree with several aspects of that study, the key point here is that Dr. Ling concludes that, assuming operating reserves are 10 percent and seasonal reserves are as he calculated, all of the balancing needs of the Northeast order can be provided by three butter ~~power~~ **powder** plants which can each process three million pounds of milk per day at full capacity, and which on operate at 67 percent of plant capacity on an annual basis. Dr. Ling then concludes that, assuming operating ~~services~~ **reserves** are 20 percent and seasonal reserves are as he calculated, all of the balancing needs of the Northeast order can be provided by four butter power plants which can each process three million pounds of milk per day at full capacity, and which on average operate at 75 percent of plant capacity on an annual basis.

But the plants whose costs were utilized for purposes of setting make allowances only operate on an annual basis at 47.9 percent of plant capacity. That was the testimony at the May 2000 milk order hearings of Land O' Lakes witness Dennis Schad, who testified that "the RBCS survey of seven butter power plants places the average utilization of those plants at 47.9." (Hearing Transcript, page 1212). USDA picked up on this fact in its December 7, 2000 tentative final decision, noting that "the capacity utilization estimates are less than 50 percent for the plants in the RBCS survey." Federal Register, Volume 65, Page 76843. USDA made the exact same observation in the October 25, 2001 recommended decision. Federal Register, Volume 66, Page 54078 ("the ~~current~~ **capacity** utilization estimates are less than 50 percent for the plants in the RBCS survey").

All else being equal, a plant that operates at a higher percent of capacity will have lower per unit of production costs than a plant operating at a lower percent of capacity. Thus, given that USDA set the make allowance so that a butter power plant operating at 47.9 percent of capacity could cover all of its fixed and variable costs, including a return on investment, it necessarily follows that a plant operating at 67 percent or 75 percent, of capacity will do so.

We can use real numbers to demonstrate this point. Dr. Ling calculates that each of the plants needed for balancing will, if operated at 100 percent of capacity, receive three million pounds of milk a day, or 1.08 billion pounds of milk a year assuming the plant operates ~~360~~ **365** days per year, which is 10.8 million hundredweights. This would result in the population of 48.384 million pounds of butter, and 87.804 million pounds of nonfat dry milk if the plant operates at full capacity, according to the amount of butter and nonfat dry milk that can be produced from a hundredweight of milk as stated in footnote 2 of Tables 3 and 5 of Dr. Ling's study. If, as Dr. Ling assumes, each of the plants will only operate at 67 percent of capacity in order to provide necessary balancing, they will then each produce 32.417 million pounds of butter and 58.829 million pounds of nonfat dry milk.

The question, which was not addressed by Dr. Ling, is---have the make allowances for butter and nonfat dry milk been set at a level that will cover fixed and variable cost, assuming this level of production? The answer is yes.

Let's start with fixed costs. The make allowances for both butter and nonfat dry milk include at least two elements to cover the capital costs identified by Ling--depreciation and return on investment (i.e., the cost of capital). Per pound of butter, the make allowance includes 1.181 cents per pound for depreciation and 0.73 cents per pound for return on investment, based on the depreciation figure in the RBCS cost of production study presented at the May 2000 hearing, the California Department of Food and Agriculture data on return on investment that was adopted by USDA. The two combined equal 1.911 cents per pound of butter. Per pound of nonfat dry milk, the make allowance includes 1.812 cents per pound for depreciation and 1.74 cents per pound for return on investment, based on the depreciation figure in the RBCS cost of production study presented at the May 2000 hearing and the California Department of Food and Agriculture data on return on investment that was adopted by USDA. The two combined equal 3.552 cents per pounds of nonfat dry milk.

When one applies this to the pounds of butter and nonfat dry milk produced at the plant operating at 67 percent capacity, one can easily calculate that the plant will receive through the make allowance $2,709,100.00 to cover its fixed costs, consisting of $619,500.00 for butter (1.911 cents per pounds times 32.417 million pounds of butter), and $2,089,600.00 for nonfat dry milk ~~butter~~(3.552 cents per pound times 58.829 million pounds of nonfat dry milk).

MR. ROSENBAUM: Dr. Yonkers, should butter be stricken from the first line on page 18.

THE WITNESS: Yes, as I read it, it should be, thank you.

This $2.7 million is more than enough to cover the $2.52 million of capital costs identified by Dr. Ling for the entire facility. Dr. Ling also identifies additional fixed costs for insurance, taxes, licenses, and administration, but each of these costs was either a line item in the RBCS survey data introduced at the May 2000 Class III and IV formula hearings at which the make allowances were set, or were explicitly added on top of the RBCS survey data results by USDA in its decisions setting the make allowances.

That covers fixed costs. As for variable costs, Dr. Ling, himself, said in his study, and repeated in his testimony at this hearing, that every one percent increase in capacity utilization results in a 0.1 cent decrease in variable costs per pound of product manufactured. Obviously, since Dr. Ling's ~~plans~~ **plants** operate at 67 percent of capacity and the variable costs covered in the butter and powder make allowance were based using a plant operating at 48 percent capacity. Dr. Ling's plants will receive more than enough money through the make allowance to cover their variable costs.

Indeed, Dr. Ling's methodology would suggest that the current make allowance is 1.9 cents per pound higher than it need be to pay for the variable costs incurred in his balancing plants, since they operate at 19 percentage points greater capacity utilization than the plants used to set the make allowance.

I could do the same calculations for Dr. Ling's ~~alternate~~ **alternative** assumption of balancing plants that provide operating reserves of 20 percent and therefore operate at 75 percent of annual capacity. But obviously, that higher capacity utilization will produce more pounds of butter and nonfat dry milk, providing even more money to cover fixed and variable costs.

This is a lot of math, but it is all intended simply to demonstrate that USDA was absolutely correct when it stated in the tentative final decision, and again in the recommended decision, that the make allowances would cover the costs of balancing.

Thus, the make ~~allowance~~ **allowances** themselves will cover all of the balancing costs that Dr. Ling identifies, and there is no possible justification for imposing marketwide service payments. In this regard, I will note that Dr. Ling's study only purports to calculate the costs of balancing, and nowhere addresses whether those costs have already been paid for through make allowances.

III. EVEN IF MORE FUNDS WERE SOMEHOW NEEDED TO COVER THE COST OF BALANCING, THOSE FUNDS HAVE BEEN MORE THAN AMPLY PROVIDED THROUGH OVER ORDER PREMIUMS.

Given USDA's decision to set Class IV make allowances at a level that will cover balancing costs, there may be little point in establishing that there are additional ways those costs can be covered without resorting to mandatory marketwide service payments. But, the fact is, such a mechanism is already in place, through the existing over order premiums in the Northeast order.

Each month a Class I user pays the Class I minimum price as determined by the Class I mover plus the plant location differential. In many markets, including the Northeast order, cooperatives then add a surcharge to this minimum price. These are the payments that cooperatives receive on every hundredweight of milk that they provide to a Class I handler.

These over order premiums may be contracted between a buyer and a supply cooperative, and can and often do include a schedule of premiums, charges, and credits for varying supplies of additional milk or timing of deliveries. The premiums also may be negotiated on an as needed basis, in which case there is often a “give up” charge added to cover the opportunity cost of selling that volume of milk rather than running it through the manufacturing plant. Regardless of the structure, the cooperative is receiving more money than the Federal Order minimum that the buyer was obligated to pay for Class I milk. These premiums are the cooperatives’ method of recouping the expenses related to any services provided to the buyer, including supply management or balancing.

USDA-AMS publishes the simple average of these over-order premiums by market city in ~~is~~ **its** annual summaries. In the northeast, the 2000-2001 year simple average for Boston, Massachusetts; Philadelphia, Pennsylvania; and Baltimore, Maryland were, respectively, $0.75, $1.66, and $1.56 per hundredweight. We can estimate the effect these premiums had on net income to all milk suppliers if we multiply the average premiums by the average Class I utilization, 45 percent, in the Northeast order. On an all milk basis the premiums bring additional revenues of $0.34, $0.75, and $0.70 per hundredweight. These receipts are far in excess of the requested six cents per hundredweight marketwide service payment that are already being provided by the market.

Another way to think of it is to see the Class I over order premiums as the “give up” charge that a cooperative charges a Class I handler for providing milk to the Class I handler rather than processing the milk through the cooperative’s own Class IV facility. The $0.75, $1.66, and $1.56 Class I over order premiums received by cooperatives are more than sufficient to cover the per hundredweight cost the cooperative incurs to provide balancing reserves, even assuming that they are not already being covered by the make allowances, which they are.

Specifically, Dr. Ling’s analysis is based upon the assumption that the need to provide balancing requires a Class IV plant to maintain substantial unused capacity in certain months, especially during the fall, so that in those months, milk that would otherwise be available for processing in that plant can be sent to Class I plants to meet Class I needs. Under Dr. Ling’s analysis, the Class IV plant will use that extra capacity to process that milk in the spring, when supplies exceed Class I needs.

Dr. Ling’s study analyzes the cost of this balancing on a month by month basis, and concludes that the cost of balancing reaches a peak of 63 cents per hundredweight in October. (Ling, page 8, Table 5). Yet the cooperative will receive more than this amount per hundredweight through the $0.75, $1.66, and $1.56 per hundredweight Class I over order premium it will receive.

IV. MARKET TRENDS HAVE GREATLY WEAKENED WHATEVER JUSTIFICATION EVER EXISTED FOR MARKETWIDE SERVICE PAYMENTS.

The proponents assert that marketwide service payments are needed because they are incurring costs associated with the need to dispose of milk during periods ~~in~~ **it** is not needed for Class I purposes. I have in previous sections of my testimony demonstrated the ways in which those costs are already and appropriately being handled without any provision for marketwide service payments. But, in this section of my testimony, I **will** address an antecedent question--whether the disposal of this “reserve” milk is a major issue to begin with.

The amount of reserve milk is largely a function of two very separate issues. The first relates to seasonal variations in both milk supplied to the market and the demand for milk to be used in fluid dairy products. The seasonal variation in Class I use in the Northeast markets has in fact changed little over time. Therefore, the major issue related to seasonal reserves is the change over time in seasonal variations in milk production.

It is extremely revealing in examine trends in the seasonality of milk production in the United States over the past 50 years. I have charted USDA data for U.S. milk production on Chart 1 of my testimony.

MR. ROSENBAUM: And Dr. Yonkers, is that the document that is now has been marked as Exhibit 22?

THE WITNESS: Yes, it is.

Each of the colored lines charts seasonality during a three year **period**, starting with the period of 1949 through 1951, the green line, and continuing, in 10 year intervals, through the period 1999 through 2001, the red line.

The chart depicts average daily milk production for the three year period as having a value of one. For each of the three year periods, the chart shows, on a month by month basis, the degree to which that month's average daily milk production exceeded or trailed, average daily milk production for the entire year. Thus, if average daily milk production during a given month exceeded the annual average daily milk production by 20 percent, that month's production was given a value of 1.20. Conversely, if average daily milk production during a given month trailed the annual average daily milk production by 20 percent, that month's production was given a value of 0.80.

What this chart reveals is that seasonality has sharply and steadily declined over time. For example, during the first time period chartered, 1949 through 1951, average daily milk production during the peak month of June was a whopping 27 percent more than the annual daily average, while average daily milk production during the dip month of December fell almost 20 percent below the annual average. The line on Chart 1 that depicts production during the 1949 through 1951 time period, the green line, looks like a roller coaster. Handling the milk produced during those sharp peaks and low valleys doubtlessly presented a challenged.

But, as Chart 1 clearly reveals, seasonality has sharply, and steadily, declined over time. A comparison of the period from 1949 through ~~1959~~ **1951**, the green line, to the 1999 through 2001 period, the red line, is particularly revealing. During the earlier period, average daily milk production during the peak month exceeded the annual daily average by 27 percent, but it did so by only four percent during the most recent period. Conversely, during the earlier period, average daily milk production during the dip month had trailed the annual daily average by 20 percent, but it did so by only four percent during the most recent period.

In other words, the swing from peak to dip was 47 percent of annual average daily production in the period 1949 through 1951, but only eight percent in the period 1999 through 2001. Seasonality has thus declined by over 80 percent over the last 50 years.

While Chart 1 covers national data, the same decline in seasonality can be seen in data relating to the three Northeast order states for which USDA reports monthly data (New York, Pennsylvania, and Vermont). Chart 2 tracks seasonality in those three states, and reveals the same precipitous decline in seasonality as has occurred on a national basis.

MR. ROSENBAUM: Dr. Yonkers, is Chart 2 the document that has been marked as Exhibit 23?

THE WITNESS: Yes, it is.

In short, if there was ever a need for the type of balancing payment advocated by the proponents, that time came and went long ago.

V. PROPOSAL NO. 7 IS HOPELESSLY FLAWED.

In addition to all of the foregoing, Proposal Number 7 is hopelessly flawed. Small handlers would not qualify for payments regardless of the balancing they perform. Large cooperatives could qualify for payments without providing any marketwide benefits whatsoever. In these respects, the proposal is a direct violation of AMAA requirements.

Moreover, the flow of milk into and out of the order causes producers in the order to pay for balancing services being provided to producers in other orders. This is the very defect that led USDA to reject marketwide service payments the last time they were considered in milk order hearings.

PROPOSAL NO. 7 Violates the AMAA. The AMAA specifies the persons who the Secretary must include as recipients of any marketwide service payments. The first group listed is “handlers that are cooperative marketing associations described in paragraph(F), and the second group are “handlers with respect to which adjustments in payments are made under paragraph(C)...” Paragraph (C) provides authority for the Secretary to make adjustments in payments by handlers so that each handler’s milk payments are based upon the actual quantity of each class of milk he used multiplied by the prices for each class. Since the payments by all handlers are adjusted to reflect their actual class usage, all handlers should be eligible for marketwide service payments.

The AMAA makes no distinctions based upon the size of the handler or cooperative. If a small handler or cooperative provides a service of marketwide benefit within the scope of any marketwide service payment program adopted by USDA, that small handler or cooperative is entitled to receive marketwide service payments.

Proposal Number 7 violates these requirements. The Proposal's criteria for receiving marketwide service payment(no more than 65 percent Class I usage, and pooling more than one million pounds of milk a day or three percent of the total milk pooled for the month) would exclude all but the largest handlers. Moreover, IDFA is not aware of any non-cooperative handler that would qualify. Thus, the Proposal violates the statutory requirement that any handler can qualify for the payment.

Proposal Number 7 violates other statutory requirements as well. The principal requirement established for the marketwide service payments is that such payments are limited to "services of marketwide benefit" and therefore, may qualify for marketwide service payments. These include providing facilities to furnish additional supplies of milk needed by handlers and to handle and dispose of milk supplies in excess of quantities needed by handlers; handling on specific days quantities of milk that exceed the quantities needed by handlers; and transporting milk from one location to another for the purpose of fulfilling requirements of milk of a higher use classification or for providing a market outlet for milk of any use classification.

Proposal Number 7 completely fails to meet AMAA requirements, because the recipients would not be limited to those providing services of marketwide benefit. All that a handler has to do to qualify for such payments is to pool a minimum quantity of milk, and transfer less than 65 percent of that milk to a Class I plant.

Thus, a person or cooperative that operates a Class III cheese plant, and does so at 100 percent of plant capacity, 365 days a year, would qualify to receive the six cents per hundredweight marketwide service payment. Yet that handler would not have engaged in any activity that meets the AMAA criteria of a service of marketwide benefit.

More generally, the proposal ignores the realities of the market, in that no two Class I plants experience the same need for balancing, at any one time, yet alone across the year. A marketwide service payment of the kind proposed here would charge all producers for costs that are in fact varying and handler specific.

The proposal would cause non-cooperative producers to bear the cost of balancing milk from outside the order. USDA’s decision in 1987 to reject proposals for marketwide service payments in the seven Southeast orders was based in substantial part on the fact that the issue of providing reserve supplies of milk to meet Class I needs is so complex and variable that no one set of regulations can cover the issue without creating significant inequities among market participants.

USDA specifically found that if marketwide service payments had been established in those orders, those payments would have gone to the manufacturing plants that were servicing milk from producers located outside those orders. USDA stated as follows: “With the extensive amount of inter-market milk movements throughout this broad area, the adoption of the proposals would result in producers in the seven markets bearing the burden of balancing milk supplies for handlers not associated with the local markets.” Federal Register, Volume 52, Page 15951, May 1, 1987.

In other words, producers in those Southeastern orders would have experienced a reduction in their pool draws(as a result of the deduction of marketwide service payments) when the only service being provided were to producers in other orders, whose pool draw was left untouched.

The evidence in the Northeast is just as clear, and is, I might mention, not an issue addressed in the Ling Study. Appendix 16 of the data that the Market Administrator introduced at the beginning of these hearings tracks by month the quantity of milk that is pooled in the Northeast order from producers located in states outside the boundaries of the order. That data show that milk moves into the Northeast order from those producers in far larger volumes in those months when, according to the Ling Study, the most surplus manufacturing capacity is needed.

Specifically, in May, June and July of 2001, more than 100 million pounds of milk a month was received from producers located in states outside the Northeast order boundaries, an amount roughly equal to five percent of the total milk pooled on the order in each of those months. Thus, the manufacturing facilities of the Northeast order are being used to balance the milk supplies in other orders, by providing a manufacturing outlet in the spring for milk in excess of Class I needs. Yet Proposal number 7 would call for marketwide service payments to be paid on the milk coming from these other areas, thus causing Northeast producers to cover the cost of maintaining manufacturing plants to balance other markets.

Under these circumstances, Proposal Number 7 would violate the important principle that the milk order system should be a transparent as possible, and that all producers who participate in the pool should be paid uniformly from it. But under Proposal Number 7, some producers will receive only the blend price, while others will receive both the blend price and the extra payment, for services that will be unidentifiable at best and non-existent at worst.

VI. THERE IS NO EMERGENCY.

The Notice of Hearing requests evidence on whether emergency conditions exist that would warrant omission of a recommended decision. Simply stated, there is nothing to suggest that the absence of marketwide service payments is creating an emergency situation that must be addressed by the immediate adoption of a six cent per hundredweight payment scheme.

Rather, far from establishing an emergency, the evidence demonstrates that Proposal Number 7 should be rejected.

Thank you.

JUDGE BAKER: Thank you. Mr. Rosenbaum, do you have anything additional we open it up for cross?

MR. ROSENBAUM: I do not, Your Honor.

JUDGE BAKER: Very well. Are there any questions? Yes, Mr. Beshore?

MR. BESHORE: Thank you, Your Honor.

Good afternoon, Dr. Yonkers.

THE WITNESS: Good afternoon.

CROSS EXAMINATION

BY MR. BESHORE:

Q Dr. Yonkers, let’s talk about USDA history, first.

A Yes, sir.

Q Do you represent your testimony to be the full and complete history of marketwide service payments under the Federal orders during the time you represented?

A No, I believe I stated that I was recounting USDA's decisions to reject marketwide service payment proposals.

Q Oh, okay. So, it is a partial, it is an elective history of the Department's consideration of marketwide service proposals then. Just the rejections, correct?

A It is the proposals that I believe are relevant here that were most similar to the one presented here, yes.

Q Well, let's, let's consider some of the proposed, some of the history of marketwide service payments that you have not taken note of in your testimony.

First of all, prior to 1985, these type of things were not allowed to us by law, correct?

A I agree with that, yes.

Q So, that the history prior to 1985 is of, some of the history you did mention was the implementation of proposals in the Northeastern orders, Order 4 at least, to make payments from the pool for transportation surplus milk, which would be declared to be illegal. Do you recall that?

A Yes.

Q You are aware of that?

A Yes, I am.

Q Okay. You didn't note it in your testimony, however. Correct?

A Correct.

Q Okay. Now, after the provisions were, of course, policy, through '85, I think you quote some policy positions taken by folks. Congress expressed the controlling policy provision for this hearing when it amended the Act in 1985, isn't that correct, and none of us have the prerogative to override that controlling policy directive in this proceeding, true?

A I made no representation that I was trying to override Congress' actions.

Q But, you disagree with that.

A I don't think I ever stated that I disagreed with the 1985 amendment to the AMAA.

Q Oh, okay. So, do you then, ~~I believe~~ **agree that** ~~that~~ it is appropriate to provide in federal orders, for the reimbursements of handlers who provide services of marketwide benefit from the pool.

A I agree that it is appropriate to have a hearing to discuss whether there is benefits of marketwide benefit and whether those benefits justify federal order action under those, yes.

Q And that the hearing establishing that they should, that they should be adopted, correct, if the hearing so establishes, they should be adopted? That is what the law provides, does it not?

A If that is what the hearing record showed and, and that is what the USDA included, then I have no argument with USDA taking that decision.

Q Okay. Now, some of the history you do report here was that after the '85 Act, there was a hearing of marketwide service payments in the upper Midwest or the Chicago Regional Order at that time ~~were incurring~~ ,**Order 30.**

A Yes.

Q Okay. Are you familiar with those proceedings?

A I have read parts of the decision from that proceeding. I was acted in the proceedings, themselves, no.

Q Okay. You have read parts of the decision. Is that your entire field area of those provisions?

A I have also reviewed some of the history documents related to the use of those provisions.

Q Such as?

A The USDA final decision, which discussed regional specific provisions -- farm provisions discussion that was issued in 1999.

Q Okay.

A The **Upper** mid-west region.

Q Okay. Well, that is another decision, another decision, decision that wasn't reviewed in your direct testimony, but I am concerned with, with the adoption of the 1987, I think, the original provisions in Order 30 for marketwide service payments.

A Okay.

Q Okay. Now, in that proceeding, first of all, Order 30 is an order which covers regional order, is an order of **low** Class I utilization historically, you are aware of that.

A I am aware of that.

Q Okay. And, but, you know, virtually got a---- **sea of milk** in Wisconsin **and Northern Illinois**, available supply of Class I marketed in that region, correct?

A Correct.

Q And you would be aware that, if you reviewed the decision, that given that large market with an abundant milk supply, the Secretary of Agriculture found it, found on the basis of a hearing, that the producers who were supplying the Class I market were incurring costs of supplying the market that were not being equitably shared by all of the producers and that it should be reimbursed by payments from the market order pool for those Class I deliveries, correct?

A I would not disagree with that.

Q Okay. Well, that is what he found, did he not?

A I am, I am not going to disagree with your statement.

Q Okay. So, it is certainly possible then that providing milk in a surplus situation, surplus market situation, **low** Class I utilization market situation to the Class I market can provide, as the Secretary found, benefits to all in the market, correct?

A Correct.

Q Which the, the cost of which are not uniformly shared and it should be reimbursed from the pool, correct?

A Correct.

Q Okay. So, you understand that today, the fact that those provisions were adopted so that the suppliers of Class I supplies in the Chicago Regional Order, received an eight cent per hundredweight additional payment from the pool, probably ~~assembled~~ **assembly** credit or ~~assembled~~ **assembly** payment, for providing services for the marketwide benefit.

A My understanding is that the payment is received by the receiving handler, not the supplying handler. And it is specifically tied to Class I milk being delivered in order to meet the requirements under the AMAA to provide milk for Class I needs.

Q ~~What~~ **Right**, the Class I milk for Class I needs receives the --

A For a specific function, specific milk that is moving to the Class I market and my understanding is that the credit for the receiving handler, not the shipping handler.

Q Do you understand the ~~cants of how some~~ **mechanics of the settlement** process in Order 30 versus Order 1?

A No, Marvin, I do not.

Q Okay. So, if I represented to you that, you know, in effect, the intent and effect of the credit is to make it available to those who make the raw milk available for Class I utilization, it has to be Class I, classified as Class I, to the alternate handler.

A I am not, if you want to represent that, you can. I am not going to agree with that. My understanding is that that credit is for the receiving handler, not the shipping handler.

Q Well, you also are aware that in Order ~~31,~~ **30, marketwide** service payments, that the Secretary found that it was, that certain persons were incurring costs of transporting milk for Class I, to the Class I handlers in that market?

A Yes.

Q And that service was a marketwide benefit, but the costs weren't being equitably borne by the market, correct?

A That is correct.

Q And, therefore, you provided for the reimbursement to persons transporting milk for Class I utilization, out of the pool, as marketwide service payment, correct?

A Well, I don't know that it was the person transporting. Once again, it was the receiving handler and it was for Class I milk and it was to, the purpose of it was largely to account for the differences in those county specific plants locations, specific Class I differential for milk that was pooled at a plant with a lower Class I differential, and then shipped to a plant with a higher Class I differential.

Q In any, setting aside ~~the cants~~ **mechanics**, the market order pool, the revenue is available to all producers, is reduced in Order 30, in order to provide for those payments or credits for Class I milk limits, correct?

A To the receiving handler, correct.

Q Correct. Okay.

Now, those credits in this marketwide service payments --

A I like them to be called credits, Marvin, that is --

Q Okay. Whether you call a payment a credit or a debit, it is net gain to somebody. It is a net loss to the pool no matter what you call it, is it not?

A Yes.

Q Okay. So, then it wouldn't matter what we are calling it. We are talking about the same economic transaction, are we not?

A The same economic transaction is what?

Q As marketwide service payments as proposed in Proposal 7.

A I don't think so at all. And these are for specific functions that are served in the Order 30 market.

Q I am not talking about the functions of the Order. I am just talking about the flow of funds. You seem to make ~~up ---~~ **a point** calling it a credit make it something different than a payment.

A And, okay, the flow of funds is the, I was calling it a credit rather than a marketwide service payment. -- I agree in either case, into Proposal number 7, or in the Order 30 assembly credits and transportation credits, that is money that comes from the pool.

Q Okay. And those payments in Order 30 were continued, or readopted by the Secretary in the ~~--~~– **new Order 30** post Federal Order Reform?

A Correct, the 1999 decision.

Q Okay. You are also aware, you did not, it wasn’t mentioned in your direct testimony, of the marketwide service payments that have existed in the Southeastern and Southwest for various movements of milk on and off those orders?

A The transportation credits to move milk into the orders for Class I use.

Q Well, they are marketwide service payments as authorized by the 1985 Act.

A I will not, yes.

Q Okay. Because in those cases, on the basis of the hearing record, the Secretary found that some parties were providing services that were of marketwide benefit, correct?

A Yes.

Q Such as in Southwest, are you familiar with the Southwest credits, which are no longer in effect, but were in effect for a period of time, transportation.
A No, I am not familiar with that.
Q Okay. Well, just let me represent a little bit about them and see what you think. In that situation, the Secretary found that some parties, ~~cooperatives,~~ **cooperative** handlers, particularly, were required to absorb the costs of transporting surplus milk out to, to long distance points for disposal and that that provided a service of benefit to everyone in the market. You could agree with that, is a fact --
A I am not going to agree with what happened, I am not familiar with the Southwest market.
Q Okay. Well, that is part of the USDA history of marketwide service payments that you ~~--~~- **know nothing about.**
A No, I did not put it in my testimony.
Q Okay. Let's, let's talk a little bit about its involvement in Proposal 7, then. You referred to it a couple of times as "purported" balancing costs or balancing payments. Is it your position, Dr. Yonkers, or of the International Dairy Foods Association, that balancing the Class I market does not involve costs?

A No, that is not our position.

Q You know it involves costs, do you not?

A Yes, that is true.

Q Okay. And the cost as, in terms of, the cost can be isolated and identified conceptually as Dr. Ling did to the cost of balancing seasonal supplies and the cost of the operating reserves necessary.

A Specifically with the methodology employed, while I do not agree with his methodology of calculating seasonality, but, applying it in his graph, I have no disagreement with the way he calculated that.

Q I mean, conceptually there are, there are seasonal balancing requirements for the Class I market, are there not? Setting aside how they are calculated, it is a real world phenomena, that somebody is going to take care of.

A You speak of it as if there is an entire Class I market. Every handler has a different need for balancing both seasonally and in operating ~~the service~~ **reserves**, because every handler has a different situation in terms of how many days a week they receive milk, what their customer profile looks like in terms of package route sales. And the seasonality of the production profile on the farms or the cooperatives that happen to be serving them, if it is a small cooperative.

Q   And there is also a market aggregate.

A   Certainly there is a market aggregate.

Q   And that is what Dr. Ling attempted to represent, did he not?

A   I think that is what he attempted to represent, yes.

Q   Okay. And you would agree, depending on how you calculate it that there is, a market aggregate need for balancing the seasonality of production of the seasonality ~~that you would~~ **of fluid** demand.

A   Yes.

Q   Now, there is also both individual and market aggregate needs to balance the operating demands of the Class I market.

A   That is correct.

Q   You, among the members of IDFA, are many of the Class I handlers in this market, I assume.

A   Yes.

Q   Now, you know as Proposal 7 doesn't charge, your members, correct?

A   I understand that. One of the reasons I am here is because many of my members in the Northeast believe very strongly that they are already paying for this, and they don't see why the farmers that shipped ~~indirectly~~ **to them directly**, should now be charged. ~~for --~~

Q You are here as a farmer advocate, Dr. Yonkers, is that --

A I am here on behalf of my handlers, my members, because they have asked me to appear.

Q Okay. Well, since it doesn't cost, the Proposal 7 doesn't cost them anything, I am wondering what dolt they have got in the fight.

A Well, maybe I can express this way. IDFA and its predecessor organizations, MIF, and IICA before and -- had had long standing policy that the pool should be shared equally by everyone. And they have always opposed taking monies from that pool for services that they very firmly believe should be provided for by the market. And you may have heard me use that word a few times in a hearing in this room a few years ago. And that is, my members believe that markets are the best way to encourage services to be provided.

Q Okay. Have you provided, do you have any information with respect to any of the individual or aggregate operating balancing needs of your members?

A No.

Q Are you, have you had the opportunity to review Exhibit 16, Dennis Schad's data, compilation, with respect to the deliveries of ADCNE cooperatives to distributing plants in Order 1?

A I don't have that up here with me, but, I was here when Dennis Schad was here. And are the tables you are referring to with the months of May and November?

Q Yes. Did you review it at that time, the time that he was testifying about it?

A What do you mean review it?

Q Review it.

A I, I --

Q Look at.

A I looked at it, I looked at it.

Q Okay. And did you analyze it?

A What are you asking me to analyze it for?

Q For what it shows.

A That there are fluctuations in the amount of milk delivered by day of the week, showed very clearly, and even with days within the month that shows variation.

Q Okay. Do you have any reason to believe those are not correct figures?

A I have no, it is not my data.

Q But, they are your members.

A Okay.

Q The handlers who are demanding those deliveries on those days and those volumes are your members.

A The handlers are demanding, they are asking for those deliveries, and for it, many of them believe very firmly they are paying for it.

Q I understand that. We can talk about that later. I am just talking about the --

A I have no reason to disagree with those tables of Dennis Schad.

Q But, as, in fact, as we, as the representative of those handlers, you can affirm, can you not, that they ~~are~~ required for their businesses, those kinds of fluctuating raw milk, raw product deliveries to meet their needs?

A I am not going to affirm for my members how they operate their plants. There is one member already on, there are some other members that will be testifying later. And they can talk about that directly. I am not going to affirm that, that represents all of my members or any individual member's fluctuations.

Q But, you don't have any data to indicate that --

A I didn't bring any data to address that issue.

Q You would agree, would you not, that meeting those fluctuating daily demands involves costs to the supplier?

A Yes, I suppose, I am trying to just think of a farm that tied his production pattern to the demand and, you know, you can't do that on a daily basis. So, yes, I agree with that.

Q Do you know any farms that --

A I just, I just said you can't do that on a daily basis. I, I was always going to make my million dollars betting the cow that you only go five days a week, but that didn't work.

Q Okay. Coupled down with the one that produced, you know, 21 million in November and 11 million ~~on ---~~ **in May** You would really hit the jackpot.

A The fact that it was different between May and November wouldn't make any difference, if they were producing at that level.

Q Okay. Do you have any information with respect to what the costs of providing those, of meeting those fluctuating demands might be to a supplier?

A No.

Q Now, if those, well, one of your contentions is that whatever costs there are of balancing, it already covered, you don't, as I understand it now, let me be clear, you are not disputing that there are costs to balance the Class I market and tailor deliveries to the demands of the, the needs of the distributor?

A I am not disputing that.

Q Okay. But, one of your contentions is that the cost are already covered in the Class IV make allowance, do I understand your testimony correctly?

A No, USDA said that and I am agreeing with them wholeheartedly.

Q Well, you are contending here today that the cost represented in Proposal 7 for supplying and balancing the Class I market, that those costs are already reimbursed in the Class I make allowance and, therefore, Proposal 7 should be rejected. That is your testimony, isn't it?

A And, and I am making that assumption or I am making that claim on the fact that USDA set those make allowances specifically to provide for balancing and they did so using data from plants that operate at 50 percent of capacity on an annual average, which by Charlie Ling's study, is far lower than they would need to provide the balancing needs in the Northeast.

Q Well, you read your testimony, I heard it. But, let me ask you this, if a cooperative such as Dairylea, DMS, or **a** proprietary ~~---~~ **handler** balances, balances to a Class I market, ~~if~~ **with** other than Class IV utilization, in what manner does the Class IV make allowance cover those costs?

A I guess I didn't address that because I hadn't really seen anything from the proponents to say it is being handled.

Q Were you in the room today when Ed Gallagher testified?

A Ed Gallagher was talking about renting capacity, but I don’t recall him telling me what class that it was going in.

Q Well, were you here and heard him testified about his, their use of all of the cheese and other facilities throughout, other class facilities throughout the Northeast as a portfolio of facilities that they rent, so called rent, to balance their milk supply?

A Okay.

Q You did, did you not?

A Okay.

Q Okay. And to the extent that their costs are incurred through renting, for economic relationships with facilities other than Class IV facilities, Class IV make allowance does nothing or does cost, isn’t that correct?

A I am not concerned with the fact that they choose to do it through another facility than Class IV. The evidence is that they can do it through Class IV. If they want to make a business decision to do it another way based on the business economics as they understand it, I would expect that they are doing it because it is to their advantage to do it that way rather than do it through Class IV. But, that is not saying that their costs aren’t being covered and the evidence is that it would be covered if they did it through Class IV. So, I can't imagine that it wouldn't be, if they did it another way. That would, to me would be not a very wise business decision to do. If you were going to do it at a loss that way, rather than run it through Class IV, where it is covered.

Q In what manner are their costs covered when they do it, covered by the class prices of the federal order system when they do it through Class III facilities?

A They don't have to do it through Class III.

Q No, but when they do, Dr. Yonkers, when they do, in what manner are their costs covered by the class prices in the federal order system?

A By the fact that they could do it through Class IV. It is there. It is available to them as an outlet.

Q Okay. Now, are you testifying to the Secretary that there is sufficient Class IV plant capacity in the Northeast to handle every possible balancing need for the Northeastern market?

A I don't know that, the aggregate plant capacity in class ~~price~~ **IV use** is in the Northeast market, so, I can't answer that question. I suspect there is a number of people that would like to know what aggregate plant capacity use is in regions of the country, but I don't have that information.

Q Where in the Class III and IV make allowance decision is there language that tells us that those make allowances or Class IV make allowances, specifically, and exclusively, I take it, is intended to cover the cost of balancing the operating reserves of Class I plants?

A I don't believe that ever specifically identified operating reserves or seasonal reserves or necessary reserves. It concluded that those plants were operating at the capacity utilization level that suggested they were doing, a substantial amount of balancing and, therefore, their costs were covered. I didn't submit the data to USDA that those make allowances were set on. It was audited data from the State of California and it was data submitted by cooperatives through the survey done by Dr. Ling, that they were ~~all~~ **Rural** ~~b~~**B**usiness ~~c~~**C**ooperative ~~s~~**S**ervice.

Q Now, Dr. Yonkers, have you done any, the next argument, one of the arguments you make about the rejection of Proposal 7 was that premiums, over order payments, should be deemed to cover a cost in balancing. First of all, do you have any information for us with respect to actual over order payment programs for balancing that any of your members make?

A No, I do not.

Q Do you have any information for us with respect to what your members pay over order to their independent producers?

A No, I do not.

Q Now, let me ask you this. Is Bern Dairy one of your members?

A I am not going to discuss our membership list at the hearing.

Q Well, let’s assume you have a member, Bern or otherwise, is Readington Farms one of your members?

A Readington Farms has testified on behalf of IDFA, not --

Q Okay. Now, he testified that he has got a group of independent producers, he pays them 50 cents to a dollar over the blend.

A He didn’t say 50 cents to a dollar. He didn’t disagree with the characterization of one of your proponents had made that that is the, he didn’t say it was specific, but between 50 and, 50 to a dollar over that.

Q Okay. Well, take it anyway you want it, if he is going to keep an independent milk supply in the Northeast, he is going to have to be paying 50 cents to a buck over the, over the blend, wouldn’t you agree?

A I am, it is based on marketing conditions and I would assume that that is not the same from year to year, nor within the year. You can say that if you wish.

Q Well, are you disagreeing that your members pay regular substantial premiums to their non member producers in Order 1?

A I am not going to testify to that because I have no knowledge that they are regular and/or substantial.

Q Don't you think that would have been pertinent information to have if you are going to come and testify in this record that, that the pool, as the proxy for those farmers, that you are here purporting to represent, don't you think that would be important information to have, to present, Dr. Yonkers?

A I relied on data published by USDA on the average level rather than on any specific level and individual plant.

Q What is the data you relied on with respect to the average level of payment of over order of premiums to independent producers in Order 1?

A I did not rely on for independent producers. I don't have any data on ~~anything --~~- **independent producers.**

Q Just the published data, to rely on, is that correct? You didn't get any data from the members --

A That is correct.

Q -- from the members who you represent with respect to what they pay the producers, but you are here to testify for the benefit of, correct?

A Let me take that apart.

I don't think there is anything in my testimony that said the over order premiums paid to non cooperative independent producers supplying the proprietary plants is part of this calculation at all.

Q Well, let's see whether ~~--~~- **it ought to be.** Well, let's see ~~whether or not~~ **if it ought to be.** Your testimony is that you pay, that handlers pay cooperatives over order premiums for balancing services, correct?

A They pay cooperatives over order premiums and from that --

Q From that --

A I don't even think they need to cover their balancing costs, because I believe it is covered, I agree with USDA, that it is being covered under the make allowance. And I believe I demonstrated that.

Q Okay. If it doesn't need to be covered out of the premiums, can we just take the III of your testimony and excise it --

A What page are you on?

Q -- for the record? Nineteen through 21.

A As I clearly state that is ~~their --~~- **there on top of that.**

Q Okay. Well, let's talk, let's talk about that. Because it is certainly not there on top of any Class III prices. But, let's talk about it.

A What is not there on top of Class III prices?

Q The over order premium, the Class I handlers pay.

A Well --

Q Class III prices was related to, you are saying it is on top, because you are assuming that the balancing costs have already been paid by the class prices, have already been contemplated through the class prices.

A Through the make allowance.

Q Through the Class IV make allowance.

A That is correct.

Q Okay. That was my reference to Class III. Somebody who has got Class III ~~, did not get -- in~~ , **are not getting it out of** Class IV.

A If they choose to balance with Class III, when Class IV is available to them, that is their business decision, Marvin.

Q Okay. And business decision of your members is to purchase substantial supplies of milk from non cooperative members, have it delivered year round to the distributing plants, every day of the year, pay them substantial over order premiums, assume with me for a moment, that the ~~declaration~~ **information** in the record is correct, that is 50 cents to a dollar a hundredweight over order. Pay them that money over order, have them delivered there every day of the year. That is a business decision by your members, correct?

A Well, it is not a business decision by all my members. I want to make that very clear. And I ~~could~~ **couldn't** even tell you how many of my members are what percent of the mill of my members that is included.

Q Okay. You don't have that information for this record, either.

A From this record or for this record?

Q For this record.

A No.

Q Okay. But, those of your members, whatever portion it might be, who are purchasing milk from the 4,000 independent farmers in Order 1, pay them 50 cents to a dollar a hundredweight, having their milk delivered to the ~~plants~~ **distributing plant** for Class I utilization every day of the year, nearly every day of the year, as we have heard testimony, that is a business decision made by your -- correct, your members.

A I believe so.

Q Okay. Now --

A They believe that that premium has been necessary to generate the supply **of milk** and milk that they receive.

Q Okay. Now, you would agree with me then that marketplace is for dairy cooperatives in the Northeast are going to ~~--~~– **retain the** milk supply, they are going to meet that competition in terms of pay that you set by paying those independent producers who provide no balancing services to your plants, they are going to beat that competition by paying a competitive pay price, correct?

A I am not going to agree with that, because I think I heard Ed Gallagher testify the fact there is only a limited amount of milk needed for Class I needs. So, that milk would be marketed --

Q As a dairy economist, how much less than that market's setting price, is DMS and Land O' Lakes, Allied, ~~Agrimart~~ **Agrimark, St. Albans** ~~--~~ how much less are they going to be able to pay and maintain membership ~~--~~– **base.**

A I think they have to be competitive in generating ~~--~~– **their milk supply.**

Q Competitive with ~~the prices --~~– **co-ops.**

A My members, they have to be competitive with

~~their costs~~ **co-ops**, though, so it is, you know, it is a vicious ~~circle~~ **cycle**. The ~~costs~~ **co-ops** have to be competitive for my members, my members, that have that independent supply, have to be competitive with the ~~costs~~ **co-ops**.

Q Right.

A I, that, that fosters, actually that is exactly the competition that provides the greatest return in the market.

Q Right. Now, for the ~~costs~~ **co-ops** to be competitive, they have to pay something comparable to the producers, to what the producers are getting paid, this ~~market~~ **milk** is not balanced in any way?

A I think that was the testimony of one of your proponents presented, yes.

Q All right. And on top of that, the cooperatives are going to have the balancing cost represented by the deliveries required by the distributing plants as demonstrated and documented ~~into ---~~ **in Exhibit 17**, correct?

A What I heard presented by your proponents was that not only can they suffer those costs, but they can still be competitive in paying in the market. What I heard Ed Gallagher say is that he is paying a competitive price in the market ~~to spite~~ **despite** the fact that he had those losses. I also heard him say that he makes it, I don't know if it was DMS or Dairylea, makes a decision to sell milk to a Class I plant rather than run it through a Class IV balancing plant based on long term relationships with his customers. And yet when he calculated and did his exhibit, which showed the losses he was exhibiting, he was only counting the milk on that exact loads, that were not going into that plant. He wasn't counting the over order premiums on all loads of milk to those customers. I think he was comparing apples and oranges.

Q He wasn't just calculating the costs involved in the balancing transactions.

A He said it was net, the revenues he was receiving on just that milk and then he also went on to say very explicitly, that the reason they were doing that was for long term business relationships with those customers. But, he wasn't including the rest of the milk he was selling to that customer and netting out and then he went on to say that he is paying his producers the blend price and being competitive with the over order premiums. He can't do that unless those over order premiums is distracting and all of that milk is covering those costs.

Q When you, the information that you used, you didn’t make any survey of what your members in Order 1 are paying on a weighted average basis for Class I milk?

A Nope.

Q Did you?

A Nope.

Q The only information that you have is the published USDA announced prices at Boston, Philadelphia, Baltimore.

A Correct.

Q Okay. You are aware, of course, that there is no, no published data on prices to New York?

A That is correct.

Q And so you haven’t even attempted to provide any data on this, correct?

A I relied on USDA published data on, and I didn’t use Hartford, for instance, because Hartford was similar to Boston, and I mean, I could have listed more cities, and I picked three.

Q Okay. You are familiar with the fact those published prices do not reflect a lot of ~~proficient~~ **additional** factors to go into the, go into the actual charge to the plants.

A My understanding is that in our region, in many regions of the country there is credits and sometimes additional charges related to specific services that are provided to Class I handlers when setting over order premiums.

Q Okay. Did you investigate those factors in the Northeast?

A No.

Q You just used the raw published prices --

A I didn't have anything else to use.

Q Well, your members did, correct?

A And you are welcome to ask them those questions.

Q I tried the first one and --

A Well, you got the same answer I get, whenever I --

Q Okay. Just so we understand, just so we understand that they, the information is not being made available for the record.

A I should also point out that the level, the exact levels of those wasn't made available by the cooperatives that were here, either. It is a competitive market.

Q Right. The, with respect to Dr. Ling's study, which you refer to here in this part, III of your testimony, do you have any major conceptual issues with the manner in which he attempted to isolate the costs of Class I balancing?

A Are you talking about II?

Q No, I was looking at page 21, where there is some references, but, I am not, I am not looking at any specific contention on that page. That is, II is fine.

A With the -- calculated the seasonal reserves, I mean he used the data that was available to him, which was producer receipts. I would not have used producers receipts because it doesn't count equal. There was some pooling in months and years of data that he looked at.

Q What would you use?

A I think you have to net out depooling and I think you have to net out movements of milk into and out of the order, such as the data. And I have no idea from '94 to '99, I did not go back to the three separate orders and look at milk from other states, like what was presented in the MA's data for 2001 and 2002, so far, that actually showed no states outside of the area. I think that needed to be adjusted for. On the receipt side --

Q Have you done that by the way?

A Have I done what?

Q Have you made, recalculated the seasonality and making any of the adjustments --

A I have the same problem that someone else, I think it Bob Wellington had, is we have such little data after the merged order to do it with and prior to the provisions were different enough that you can't just assume that you can take the data from each of the three orders and pool it.

Q You mean, 20, 24, 30 months -- less than 60 months.

A When you are doing the 12 month seasonal trend, which is what Dr. Ling did, you have to throw out the first six months and the last six months of your data set. It doesn't leave you very much to go with.

Q Okay. So, what about other, did you consider other, what about in season fluid demand, do you have any problem with that?

A Well, once again, you would want to account for moved transfer diversions, packaged sales in the area from over order plants and going out of the order to other order, not only plants, but actually route distributions that are outside that may be pooled there. And most of that data was restricted, so there was absolutely no way to make those adjustments and costs when researching the order.

Q Well, you could take, you know, an area of distribution of the order --

A I mean, you can make some adjustments, but you can't adjust for all the transfers and diversions, those tables in the DMA data was just full restricted data.

Q By the way, there is a billion between a billion one on average of Class I utilization in Order 1 per month, correct?

A Okay.

Q Now, are there any, all these numbers that you said should be taken out or put in or offset or corrected or whatever, are there any numbers that are material in the context of a billion to a billion one average pounds of Class I utilization per month?

A We are talking about looking to seasonality.

Q Right, that is right. And we are talking about moving the 12 month average.

A I will look in particular at the milk coming in from other states.

Q **I'm** ~~On~~ **on** the fluid demand side.

A You are only on the fluid demand side, right.

Q Yes.

A But, I don't know because the restricted level of the data, I have no idea and if it happened more in certain ~~lengths~~ **months** than others, it can affect the seasonality.

Q In a material manner.

A I can't answer that question without seeing the data. And I can't see the data because it is restricted.

Q Now, are you here to testify, Dr. Yonkers, I want you to think about this, as an expert in the field, that in a market with a billion or billion one of pounds of Class I utilization per month, that the restricted movements of milk, milk by less than two handlers, a packaged milk from, ~~over~~ **Order** one distributing plant, into Order 5, for instance, are likely to be of such volume to be material when you are using those aggregate numbers to calculate seasonal indexes and the like?

A I will give you this. I don't think those movements of milk are going to be very large. But, I don't think it has to be very large to affect the seasonality, because remember if you look at, remember from Charlie Ling's graph and his publication, you are actually bringing down the seasonality of production, down to the point at which it is most limiting on the seasonality, on the fluid demand. And so, small changes in either one of those seasonalities could affect where that occurs and to the extent that seasonal reserves are necessary. I am not going to sit here and say that even small changes in those seasonalities wouldn't substantially impact the amount of seasonal reserves that are necessary. I will admit that it will not adjust the seasonality of the demand, the Class I usage all that much, but it may not take much to have a bigger impact under the seasonal reserves. I just don't, I, I don't know because I do not have that data.

Q Well, you could, you don't have the data of actual movements, but if you care to, you could calculate what percent, what volume of distribution it would take to move those, you know, move those percentages of any Dr. Ling's tables --

A Somebody could. I didn't, I am not going to. Somebody could.

Q Let me just go back to the Class IV make allowance, just a minute and then I will be ready to yield the microphone.

There were a number of costs discussed by various of the proponent witnesses for Proposal 7, and I wonder if you could confirm for me that they, their costs that were not specifically discussed in any of the class, Class IV make allowance, ~~towing~~ **tolling** charges of any kind of were not at, processing plants were not discussed in the Class IV make allowance, correct?

A I don't know if there were any plants that had ~~towing~~ **tolling** arrangements that were included in either the California data set or the RBCS data set.

Q My question was just, they weren't discussed in the decision.

A Correct.

JUDGE BAKER: You want the, you said they were --

MR. BESHORE: The Class IV make allowance.

THE WITNESS: I don't recall ever reading that or ever hearing about that, but, I don't know that plants at which ~~towing~~ **tolling** occurred, could have been included and to the extent that their ~~towing~~ **tolling** charges were based on their costs. That maybe. I can't say that they are not, they are completely irrelevant, ~~I am just not ---~~ **they are just not there in the decision.**

BY MR. BESHORE:

Q No, I agree. My question was can you confirm that they were not discussed?

A Can I confirm? I don't, you know, I could go through my, I could do a find on ~~towing~~ **tolling** and I bet you I am not going to find any.

Q How about, how about hauling and additional hauling costs to dispose of milk for balancing purposes, that was not discussed --

A Well --

Q The Class IV make allowance wasn't.

A No, I don't think it was because the RBCS was only in plant costs, that they ignored that part of their survey, and I don't believe California has anything on that either --

Q Okay. You -- some lost zones, price **values** as Mr. Gallagher discussed this morning, that was then discussed in the Class IV make allowance, was it?
A No, but it is handled other ways in other orders, currently.
Q Okay.
A Order 30.
Q By making the marketwide service payment out of the pool.
A I agree, it is handled in other way, that is not a proposal here.
Q Loss handling charges from, as Mr. Gallagher discussed this morning, were not discussed in the Class IV make allowance.
A If, if there are things that should have been considered in the Class IV make allowances, I, you know, it should have been put into the record there and ~~having sections --~~ – **have exceptions filed.** No, I don't recall any of these things being in there, Marvin.
Q Right and that is, that is precisely --
A Our, our testimony at that hearing was that all costs associated with taking farm milk, manufacturing and selling the products of that, ought to be included in those make allowances.
Q Whose testimony?

A IDFA's testimony.

Q On Class IV make allowances?

A On make allowances, period.

Q Well, I think you made the clear distinction in your testimony that you didn't --

A I did not specifically mention anything, but on make allowances in general, but a significant part of my testimony dedicated to make allowances, period.

Q Okay.

A And I believe all costs should be covered.

MR. BESHORE: That is all I have, Your Honor.

JUDGE BAKER: I promised everyone, we will take a break every two hours. If anyone needs a break a five minute break at any time, just let me know. Otherwise, we will go on our two hour schedule.

(Whereupon, a short recess was taken.)

JUDGE BAKER: Back on the record.

Dr. Yonkers is on the stand and is being subject to cross examination, and -- Yes, Mr. English?

First, Mr. Rosenbaum, have you finished with this witness on direct?

MR. ROSENBAUM: Yes, and I think Mr. Beshore finished as well.

JUDGE BAKER: Mr. Beshore, have you finished?

MR. BESHORE: I have just --

JUDGE BAKER: Oh, you have not.

MR. BESHORE: Could I have just one more? I have a, just a couple of questions.

JUDGE BAKER: All right, All right.

BY MR. BESHORE:

Q Dr. Yonkers, the Class IV make allowance decision established prices under the make allowance, class prices on a national basis, you would agree with that?

A Can you ask that question again?

Q The Class IV, Class III and IV make allowance hearing, I am calling.

A Price formula hearing.

Q Price formula hearing, established those price levels, price formulas on a national basis for all orders uniformly, you would agree?

A For all portions of the formula which included product prices, yield factors, and the make allowance. I would agree with that.

Q Right. And the Class III price is the same in Order 1 and Order 135 and every order in-between.

A Yes.

Q And Class IV price is the same way.

A Yes.

Q Okay.

A Everywhere ~~by~~ **but** California and the state orders.

Q Well, the federal system, federal order system.

A Correct.

Q Okay. Marketwide service payments are necessarily market specific.

A They should be market specific, I would agree with that.

Q And with respect to the issue that you have commented upon, on the hearing in the Southeast, where there were inequities observed by the Department in terms of surpluses on one order, versus high utilizations on other orders, and that being the primary reason for rejection of those proposals. There was seven orders involved in that, in that hearing, were they not?

A That is correct.

Q Okay. And do you recall, I ~~doubt~~ **gather** if you have reviewed the record of that proceeding to some extent in preparation here, do you remember that those inequities involved among things an order ~~--~~ **having** - -. One of the orders at least having a Class I utilization in excess of 100 percent on some occasions?

A I don’t recall that specifically, but, if you say that is there, I am not going to disagree.

Q In any event, some of the orders have Class I utilizations that were extremely high and others had, that were geographically adjacent had Class I utilizations that were ~~material and~~ **materially less**.

A Okay.

Q And that was the problem there.

A Well, one of the problems there.

Q One of the problems there. The primary problem --

A Maybe as a result of that, and other issues there was milk that moved between those orders quite a bit. And that, to me that is the, the problem is the milk moving around between those orders at different times of the year and if one of the reasons they did that was those, that is one of the reasons. And I won't disagree with that.

Q Okay. We are only dealing with one ~~of them~~ **order** in this case, however.

A You are, but the borders are not sealed. I mean, we do have open borders at least through the south into the west.

Q Right.

A I mean, you can't close them off entirely.

Q I agree.

Now, one question with respect to your

interpretation of how Proposal 7 would apply. On page 26 of your testimony, Exhibit 21, you reference what I gather you believe to be an example of an inequitable operation of Proposal 7 by indicating that the person or cooperative who operates a Class III cheese plant, 100 percent capacity, 365 days a year, would qualify to receive the six cents per hundredweight. Do you see what I am talking about?

A I see where you are.

Q Okay. Now, operating a cheese plant does not at 100 percent of plant capacity, 365 days a year, does not quality for you marketwide service payments under Proposal 7, does it?

A They would have to meet minimum volume requirements.

Q Okay.

A And they would have to meet the shipping requirements to qualify under the order.

Q Right. So --

A But, that doesn't mean that they could be doing that and still not operating a plant.

Q Well, the plant would not represent that full operation.

A I didn't say it did represent and I would not disagree with that statement.

Q Well, the rest of their operations, well, assuming that it was possible for somebody to do that, they would have to have enough milk supply to put in that plant full capacity, 365 days a year, correct?

A And meet the other obligations under the order, that is correct.

Q Right. And balance that plant with other utilizations, Class I deliveries, etc., throughout the year if you are going to keep it full for the whole year, correct?

A Yes.

Q The delivery requirement under the order would involve minimum requirements of at least 10 percent, 20 percent during the indicated months.

A That is correct.

Q And if Proposals 5 and 6 are adopted, it would be, there would be year round requirements for delivery to distributing plants under the order. You understand that?

A Remind me what five and six are? There is one that would raise them in the fall to 15 and 25.

Q That is not five and six. Five and six would establish, I guess it is, well, five and six together would establish 10 and 20 percent requirements year round. Ten percent --

A Okay.

Q -- basically December through --

A Okay.

Q -- August. Okay. So, that assuming that there is year round shipping requirements, that plant operator is going to have be supplying at least those volumes to distributing plants --

A Well, ~~they already~~ **in order to** ~~qualified~~ **qualify** for the marketwide service payments, they have to qualify under the order.

Q Right. And you can't qualify under the order just by operating the cheese plant 365 days a year.

A I didn't mean to imply that.

Q Okay.

MR. BESHORE: Thank you. That is it.

JUDGE BAKER: Thank you, Mr. Beshore.

Mr. English?

MR. ENGLISH: I guess I won't comment on Mr. Beshore with counting of questions.

CROSS EXAMINATION

BY MR. ENGLISH:

Q Do you have Exhibit 5 in front of you, Dr. Yonkers?

A Yes.

Q Acknowledging that a lot of the data is unavailable, nonetheless, if you could turn to page 82 of

Exhibit 5.

A Okay.

Q This is the Class I sales by Northeast Order **pool** Distributing Plants Inside and Outside the Marketing Area. And I think in answer to questions from Mr. Beshore, he suggested that perhaps a more relevant way would be, not so much the total quantity of Class I milk but the seasonality, correct?

And so looking for a moment to the months that Dr. Ling used as the months of greatest change, in June, October, for instance, you have 915 million, 304,000, 677 total Class I utilization in the far right column.

A Yes.

Q For June. And you have over ~~a billion, -- million -- nine oh eight~~ **1,23,633,908** for total Class I utilization October, correct?

A That is correct.

Q Which is something in the neighborhood of about 108 million fluid demand changeover that are taken, that appears in his table one over the months and years, correct? In terms of to be used --

A Less than a hundred million, but just under 100 million.

Q Right. Now, if you look at the two columns prior to that, you have Class I sales ~~--~~– by **Northeast**

order handlers and other federal order markets and Class I sales by Northeast order **handlers** in non federal order markets. Both categories of the Southeast decision discussed with respect to differences. You have a change from June to October of 8.8 million, 21.78 million for the column “Class I sales by Northeast order handlers and other federal order markets” and you have a change in June of the next column Class I sales by Northeast order handlers in non federal order markets of 82.6 million to 104 million.

A Yes, and let me go back and say that I was looking at the November number on the far right column when I said it was less than a million. I now agree with you that it is a million eight.

Q Okay, 108, right.

So, but if a 108 million, you are looking at almost 35 million being due solely to package sales. There is nothing to transfers or diversions, for which we don’t total information. Thirty five million of 108 million, do you think that is material in terms of that seasonality?

A Yes, looking at the net of that, would be the first column, which is the in area sales and that certainly is between those two months, June, October is significantly less than the 108 million by your 35. Yeah, that does indicate by seasonality.

MR. ENGLISH: Thank you. I have no further questions.

JUDGE BAKER: Thank you, Mr. English.

Are there other questions of Dr. Yonkers?

(Pause.)

JUDGE BAKER: Let the record reflect that there are none. Thank you very much, Dr. Yonkers.

THE WITNESS: Thank you, Your Honor.

(Whereupon, the witness was excused.)

MR. ROSENBAUM: Your Honor at this time I would move that Exhibits 21, 22 and 23 be admitted into evidence.

JUDGE BAKER: Are there any questions, or objections? Let the record reflect there is no response. Exhibits 21, 22 and 23 are hereby admitted and received into evidence.

(The documents referred to, having been previously marked as Exhibit 21, 22, and 23 were received in evidence.)

JUDGE BAKER: Mr. Rosenbaum, did you have someone else?

MR. ROSENBAUM: No, Your Honor.

JUDGE BAKER: Oh, you didn’t, all right. Thank you.

Mr. English?

MR. ENGLISH: Your Honor, first of five witnesses, Dave Arms.

(Pause.)

MR. ENGLISH: Your Honor, Mr. Arms has a statement, actually it is two statements. One is sort of a summary of New York State Dairy Foods, another is more directly related to Proposal 7. And then there is also an exhibit, I would ask that each of these three be marked and I have copies for you and the court reporter.

JUDGE BAKER: Very well, thank you.

(Pause.)

JUDGE BAKER: Mr. English, you are handing me some documents and you have requested that they be marked for identification. And so, the first document is a statement by Mr. Arms.

MR. ENGLISH: It is a statement which does not say --

JUDGE BAKER: Well, in any event, this document you handed me --

MR. ENGLISH: Is a three page document.

JUDGE BAKER: Three page document and that is to be marked --

MR. ENGLISH: I am sorry, it is four, I am sorry it is a four page document, cover sheet, then it has two pages of text, followed by one page that lists the members of New York State Dairy Foods and other organizations that are supporting the New York State Dairy Foods for this purpose.

JUDGE BAKER: All right. That should be marked for identification as Exhibit 24.

(The document referred to
was marked for identification
as Exhibit 24.)

MR. ENGLISH: And the next document, Your Honor.

JUDGE BAKER: Very well.

MR. ENGLISH: Is a longer statement on Proposal 7, which specifically says ~~Dairy~~ **hearing** Proposal number 7. Statement ADCNE Proposal number 7, otherwise Marketwide Service Payments by David Arms, Economic Consultant.

JUDGE BAKER: Very well, let's mark that statement Exhibit 25.

(The document referred to
was marked for identification
as Exhibit 25.)

MR. ENGLISH: And then there is an exhibit, Tables 1 through 3, which is a four page exhibit. The cover page plus three tables.

JUDGE BAKER: Very well. Mr. English, that shall be marked for identification as Exhibit 26.

(The document referred to was marked for identification as Exhibit 26.)

MR. ENGLISH: I think ~~if I can assess~~ **it might make sense** Your Honor for Mr. Arms to first read a witness background and which is also a document I don't propose to make an exhibit. But, I have handed out as well, and have provided Your Honor.

JUDGE BAKER: Do you want that marked?

MR. ENGLISH: He is just going to --

JUDGE BAKER: Oh, all right, thank you.

Whereupon,

DAVID C. ARMS, SR.

having been first duly sworn, was called as witness herein and was examined and testified as follows:

MR. ENGLISH: Mr. Arms, if you would first give your background.

THE WITNESS: Yes, sir.

I will read it. My name is David Arms. I am an agriculture economist specializing in dairy marketing and **regulatory** issues affecting the industry.

My office is located at 145 Pinehaven Shore

Road, Suite 2092, Shelburne, Vermont 05482.

I am employed by ~~--~~– **Berkshire** Dairy and Foods Products, Inc., -- Services Firm, located in Wyomissing, Pennsylvania. And also with Naturally Better Dairy and Food Products, Inc., a family owned brokerage business with an office at the same Shelburne, Vermont location referenced above.

At this hearing I have been retained directly and independently by New York State Dairy Foods, Inc., to present testimony on their proposals presented for consideration at this hearing.

My career spans more than 40 years. And I have testified at numerous milk hearings in New England, New York, and the Mid-Atlantic areas. Currently I am privileged to serve several milk handlers operating in the Northeast Order marketing area.

I have a dairy farm background. And after serving with the U.S. Army, **attended and** graduated from the University of Vermont with a Degree in Agriculture of Economics in 1959, followed by graduate work at Penn State University, leading to a Master's Degree in the same field in 1961. Following graduation from Penn State, I accepted a position with USDA, first as a trainee in the same building ~~as the~~ **in the St. Louis** Market Administrator's

Office and then as a junior marketing specialist in the Dairy Division of USDA in Washington, D.C.

Other employment background includes positions as economists with the United Farmers of New England, Cambridge, Massachusetts, Executive Director, Cooperative Dairy Economic Service, a federation of operating cooperatives in New England. ~~Manger~~ **Manager**, Richmond Cooperative Association, Richmond, Vermont. Economist with the Northeast Dairy Cooperative Federation, Syracuse, New York. And an economist with Dietrich's Milk Products, Reading, Pennsylvania.

MR. ENGLISH: Your Honor, with that background, I would move that Dr. Arms, Mr. Arms be accepted as an agriculture, as an expert agriculture economist and in milk marketing orders.

JUDGE BAKER: In milk marketing --

MR. ENGLISH: For milk marketing orders, yes.

JUDGE BAKER: Very well. Are there any objections to Mr. Arms being declared an expert in agriculture economics and milk marketing orders? Hearing no response, he is so declared.

MR. ENGLISH: It make sense for Mr. Arms to give the statement that is Exhibit 24?

JUDGE BAKER: Very well.

MR. ENGLISH: And, and, Mr. Arms, for that purpose, I would have you read only the first, the first few pages and then we will discuss the third page.

TESTIMONY OF DAVID ARMS:

THE WITNESS: New York State Dairy Foods, Inc. is a full service trade association located at 201 South Main Street, Suite 302, North Syracuse, New York 13212-2166. It has been in operation since 1928. The association by way of dues paying memberships, represents companies and businesses which sell dairy products such as milk, cheese and ice cream in New York State. Currently the total number of members in the association is 128. These members are comprised of many large multinational firms, large and small processors, manufacturers, distributors, small family operations, retailers and a very small amount of dairy producers doing business in and around New York State.

The organization’s mission statement is to provide members with cost savings services and pertinent industry information that will allow members to continually serve and improve their operations all in an effort to provide the freshest and safest dairy products possible.

The association Executive Vice President, Bruce ~~We~~ **W.** Krupke has asked me to provide you with some important information regarding the processing and manufacturing industry in New York State. New York State is the third largest milk producing state in the nation. The association's members clearly recognize the importance of maintaining a strong milk producer base in our state. We also appreciate the ability to purchase vast quantities of raw milk within the region. Without ~~day~~ **dairy** farmers to provide raw milk there an not be a strong processing industry in New York. We believe in maintaining the integrity of the federal order system in the region.

It is also very important for the producing community to remember that without local competitive, innovative and efficient milk processors and dairy product manufacturers to sell raw milk to, dairy farmers will be at a major disadvantage.

According to the New York State Department of Agriculture and Markets, in 1967, there were 487 processing and manufacturing plants in New York. In 2002 there are only 90 remaining. This is a very disturbing trend to say the least. Proprietary milk handlers need the ability to procure milk from a variety of competitive sources to survive. They cannot and should not be forced to adhere to rules and regulations, which are discriminatory, anti-competitive in nature or onerous which might put them at a procurement disadvantage.

One example of a major change which affected processors and manufacturers in the new Northeast Federal Order implemented in January 2000 was the moving of the producer payment dates for milk. The shortening of payment dates by as much as seven days for the first month of the new Order meant a reduction of millions of dollars in cash flow for all operating processors. This decrease in cash flow severely restricted their ability to compete in the marketplace by reducing marketing program budgets, sale incentive programs, entrance into new sales territories and advertising budgets. The end result in that fluid milk and dairy product distributors lost strength against competing beverages in the marketplace ~~be~~ **because** of the decreased cash flow in their businesses.

Please keep in mind these facts and figures when considering proposals presented by association members. The association urges USDA to remember to weigh the needs carefully of the farming community equally with that of their customers, the dairy processors, and manufacturers in the Northeast Order in deciding what is best for the entire industry.

DIRECT EXAMINATION

BY MR. ENGLISH:

Q Mr. Arms, the third page of this statement is a list of both the New York State Dairy Foods members who have approved this testimony, and proposals, and in addition, the list of ~~any~~ **eight** other Northeast Dairy processing companies who have registered themselves in favor of all proposals on which you will be testifying, correct?

A That is correct.

Q And for the record, while this evening or afternoon you are testifying only on Proposal 7, you will be back to testify on Proposals 1, 2, 3 and 4 and --

A And 14.

Q Fourteen. Correct?

A Yes, sir.

Q Before you give your statement that is Exhibit 25, why don't we briefly discuss what is Exhibit 26.

The first page of, the first table of Exhibit 26 is basically just a lay out of partial and final payment dates and I will get to the other column in a moment, but, this is just taken directly from the order provisions and the Market Administrator has announced what those dates will be, correct?

A Yes. It is contained in Exhibit 5, ~~the data, the -- data.~~ **also the same data, the original data.**

Q And then you have also calculated a spread in days.

A Yes, that is my own computation.

Q And that is basically the difference between the partial and the final payment on the first set of columns and the difference for the payment and the producers settlement fund ~~and~~ to the payment ~~is resulted from~~ from the producer-settlement fund, in the second column, correct?

A Yes, ~~and by way of~~ **it is my way of** organizing, ~~it is~~ **it so I can better understand the spread.** ~~under spread.~~

Q According to Table 2, this data was also sourced from the Market Administrator's data, correct?

A Yes, it was.

Q This is also found in Exhibit 5?

A Yes, and I can identify the pages in Exhibit 5.

Q Would you please do that?

A The data comes from different tables and I assembled this for reasons of wanting to come up with computations, which are, clearly state. The first column, Market Total Production, comes from page 58 of Exhibit 5, I believe.

Q Yes, it is Exhibit 5.

A The same, the table, the column next to it, Cooperative Volume, this is total cooperative volume, comes from same page in Exhibit 5.

And likewise the same is true with regard to the column showing the **total** number of Independent. And incidently this is volume of milk.

The third column showing total of 9(C) milk.

Q You mean the fourth column, right?

A Yes, I am sorry.

Q The fourth column is 9 (C) milk.

A Is total 9(C) milk, which is shown on Exhibit 5, page 78.

I would note also for the record that under the new **reform** order, the definition for cooperatives, cooperative ~~for~~ 9 (C) milk ~~and they --~~ **enables certain** independent ~~users,~~ **producers** and ~~some other~~ **smaller** cooperatives to join in cooperative 9 (c) groups, **of** the larger **kind**.

This is the total 9 (C) as prepared by Mr. Frederick --

Q Your statement that, that ~~Dr. Frederick would have --~~ **after Federal Order Reform** independent supplies and others can be combined in for 9 (C) milk, is that reflected in the fact that, for instance, in more recent months, that the total 9 (C) milk exceeds the quantity of co-ops, as I say, the fourth column, second column.

A It couldn’t happen otherwise.

Q And what is the last column?

A The last column was prepared for us by ~~Pete~~ **Peter** Fredericks, and is contained in, on page 81 of Exhibit 5. It shows a total volume of the milk estimated by Mr. Frederick as the total cooperative marketing, total cooperative volume of the ADCNE group that would be receiving the marketing service, that are proposed to receive the marketing service payments.

Q Does that data then translate to the next table anywhere?

A Yes, it pertains to the same issue, cooperative service payments.

Q And so what is table --

A Before we leave Table 2.

Q Yes.

A I should point out that the, well, the factor that we feel is very important involves the total market share of all milk in the new ~~based~~ Northeast order, that would be handled as 9 (C) milk. And which involves also the cooperative 9 (C) milk **subject** to the marketwide service payments. This is over the years 2001 and 2002 in six month intervals. And I want to say that I excluded the year 2000 deliberately, because we are finding that data for 2001 is more reliable because there was confusion, in some instances, on the year 2000.

Q So, Table 3 then is a calculation of estimated impact on the uniform price and this also came from the Market Administrator's statistics.

A Yes. In the case, well, what I was trying to do in this table is to set forth the cooperative service payments actually made in the last two years when they were effective in the New York and Jersey Order. So, what is shown here is the 1998 and '99 volumes of total milk, cooperative qualifying volume, and the exact cooperative payments deducted from the pool. And the calculations on the uniform price, the impact on the uniform price, which **are** my calculations and the data all came from the Uniform Price Announcements, Monthly by the Market Administrator.

The data in the last table, for 2001, not table, part of this table, came from, again, from Exhibit 5 and the same materials I have referred to before.

Q Do you have any other comments at this time on tables that are in Exhibit 26?

A In the, in my statement I refer to these tables. And at the time that I wrote, back to the statement, I referred to the tables as being attached. We made a decision here to make the tables as a separate exhibit.

Q Okay. Would you then please give your statement that is Exhibit 25?

A Yes.

(Pause.)

THE WITNESS: Does the recorder have a copy of the statement?

JUDGE BAKER: I believe he does. Thank you so much.

THE WITNESS: Well, on the first page, I want to make clear that this is a statement on, specifically on Proposal 7, Marketwide service payments, and it is being made by me as an independent economic consultant on behalf of New York State Dairy Foods.

And then the specific members supporting this statement, previously went into the record.

The New York State Dairy Foods, Inc. members and non-members alike, hereinafter listed individually oppose the adoption of Proposal Number 7 as presented in the official Notice of Hearing, calling for the establishment of marketwide service payments exclusively for Northeast Federal Order Number 1. The undersigned are opposed in principle ~~t~~ **to** the use of pool monies paid by all pool producers for unrestrictive uses. We do not think it wise to set-up what amounts to a corporate welfare labeled as balancing service payments. As written, we believe the adoption of Proposal 7 would lead to divisive and disorderly milk procurement practices, promote inequities among handlers, lessen competition (particularly from small business enterprises), and not be in the public interest.

Proposal 7 provides for pool payment to qualified organizations @ $0.06 per hundredweight for rendering unspecified balancing services for the fluid market. To qualify:

- Handler must pool at least three percent of the market “pool producer milk” (approximately 61.4 million pounds out of 2.05 billion pounds market milk per month.); or
- Handler “pools” and/or operates a pool manufacturing plant (Class III or Class IV use) or a pool distributing plant located in the defined Northeast marketing area, handling at least one million pounds milk daily; and
- Handler transfers or diverts to distributing plants not more than 65 percent of the total quantity of milk “pooled” by the handler.

SOME OF THE ISSUES INVOLVED THAT HAVE NOT BEEN SATISFACTORILY ADDRESSED IN THE PROPOSAL ARE

AS FOLLOWS:

1. SCOPE OF THE PROPOSAL IS UNREALISTIC AND DISCRIMINATORY.

Proposal 7 more appropriately should be considered in a national rather than a regional hearing, especially in view of the Department's desire to achieve more uniformity in regulatory provisions among the Orders. Although precedent for co-op service payments existed under the former NY-NJ milk marketing Order, the plan was not the same and was not adopted under the "Reform" Orders. Because the proposed pool deduction in Order 1 is significant (close to $1 million monthly), it would be expected to have far-reaching impact on inter-market competition. For example, if the funds were used to subsidize plant operations or defray plant losses in regional manufacturing of such end-use products as butter, nonfat dry milk or cheese, this use of the funds would give Northeast cooperatives a special competitive advantage over their counterparts in other regions-who complete in the same national and international markets. Clearly, this is contrary to USDA efforts to make the Class III and Class IV milk pricing formulas uniform throughout the Federal Order system. Having the ability to use marketing service monies in only one region to lower production costs, makes a farce of the uniform "make allowances” in the manufacturing milk price formulas now contained in all the Orders.

Proponents unrealistically assume that market premiums, competitively determined aren’t doing the job they now are asking the pool to absorb. After all, buyer handlers aren’t forcing the ~~cps~~ **cooperatives** to accept or handle more member milk than they need. And several fluid handlers are paying higher premiums now than they were only a few years ago-for balancing privileges as well as for other costs of milk assembly.

Proposal 7 is unrealistic too, from the standpoint of its obvious “exclusively” for ADCNE cooperatives. While claiming participation could be available to both cooperative and proprietary handlers, proponents have clearly drafted the qualifying standards (referenced above) for themselves and to exclude others. Few, if any, proprietary handlers would qualify for service “payments”, even though some are performing valuable “balancing” services for the fluid market and could do more “balancing”, given the regulatory tools and incentives to do it. We also note that, none of the small co-ops in the market can qualify on their own, regardless of the relative level of balancing services they may perform for their fluid customers. Clearly, <u>the proposal discriminates against small business enterprise--</u>

both proprietary and cooperative.

2. PROPOSAL PROMOTES INEQUITABLE COMPETITIVE ADVANTAGE IN PROCUREMENT.

In previous testimony, we pointed out that, because of changes in cooperative 9 C unit provisions under order reform, favorable to the ADCNE cooperatives, we find that the Order 1 9C unit milk now enjoys market share exceeding 80 percent, even though total cooperative membership share is less than (see New York State Dairy Foods, Inc. Table 2). The prime reasons co-op 9 C unit milk has captured so great a share of the market, comes from the new-found ability to "pool" other non-member producer milk (both independent and smaller co-op producers) in their 9 C units. **At this point, I would also like to say off the record that a similar 9(B) provision in the New England order prior to the mergers was available to members only.** We are of the opinion that Proposal number 7, if adopted, would greatly accelerate this trend to larger market share in co-op 9 C milk--dominated by the larger cooperatives qualified as recipients of the marketwide service payments.

Why do we expect accelerated growth in co-op 9 C milk, were Proposal 7 to be adopted? The answer is made clear from past performance in the former New York-New Jersey Order 2, prior to reform. We are aware of instances where larger cooperatives secured “affiliation agreements” such that a smaller co-op could participate in service payments from the Order 2 pool. This was accomplished by virtue of special contract, allowing the smaller “affiliate” to draw service payments, albeit indirectly via the “larger cooperative”, without the smaller “affiliate” unit losing its separate identify or marketing autonomy. To qualify as a “partial” participant under the new proposal for pool competitive service payments, a non-qualifying cooperative needs only to agree to become pooled under the larger cooperative “9 C umbrella” unit and make a deal similar to that previously used in the New York, New Jersey order, to once again share in the service payments generated from the transaction. The incentive to make this sharing arrangement would be much greater under this plan; however, because of the rate of payment and the amount collected is so much greater.

TABLE 3 of Exhibit 26, clearly demonstrates this fact. While the average “rate” per hundredweight is increased about two (2) cents; the volume to which it would apply is increased more than two-fold (225 percent) and total deduction from pool monies is increased three-fold(338 percent) -- from about three million a year to more than 10 million, when compared with that which applied in former Order Number 2, which I had shown for the years ‘98 through ‘99.

Number 3. **PROPOSAL LACKS PERFORMANCE STANDARDS TO JUSTIFY EARNING SERVICE PAYMENTS FROM THE MARKET POOL.**

We believe the adoption of the ADCNE plan, as drafted, could easily result in increased share of “qualified” milk and monthly pool payments exceeding one million dollars--all without guidelines as to how three monies are to be used.

Unlike the former co-op payment provisions in Order 2, which did set forth conditions to be met by recipients, Proposal 7 contains no meaningful performance standards for “earning” the higher payments proposed to be deducted from market pool proceeds.

There appears to be no restriction regarding the sharing of market-pool co-op service payments with smaller cooperatives, who otherwise would not qualify. We believe this situation, if approved by USDA, would lead to rapid conversion of the “smaller” 9 C units into larger ones who fully qualify. This would give substantial power to the “majors” to solicit the “minors” using pool monies. Such actions would seriously diminish competition and tend to be contrary to the very “service” aspect ostensibly intended by proponents. We think this detrimental to handler competition in milk procurement and contrary to the purposes of the Act requiring that minimum uniform prices be paid all market producers. There is also no restriction against recipients using part or all of the monies to enhance net pay to their own members, or to other independents who might decide to "join" the cooperative. Use of the funds in this manner would, in effect, raid the "pool" to boost a membership advantage at the expense of those who choose not to join. We think the market needs to be protected from such unwarranted use of pool monies. Under these circumstances, one might question whether such authority was intended for cooperatives pursuant to the Capper-Volstead Act. Why grant "carte blanche" to recipients from such a large pool of money? At the very least, Proposal 7 should have been designed to include more players, proprietary and cooperative alike, who can demonstrate, in accordance with specific "guidelines", that they indeed are equipped to able to do the daily work of balancing their fluid customers-in both the "flush" and "short" supply seasons. Relative "size" of the payment recipient is not as important as actual balancing performance. The proposal lacks a "fair" performance criteria. Simply because a major cooperative or a Federation pools more than three (3) percent of total market milk, or has a large manufacturing plant, doesn't necessarily mean it has capacity enough or sufficient milk to balance the needs of others; except at steep discount rates or at very high “spot” handling charts. Membership needs may rank first and foremost, despite the “pool” service payments coming from **all** market producers ostensibly for “balancing” the entire market. Under such circumstances, the “pool assessment” is wasted.

The data in Table 3 --

MR. ENGLISH: Exhibit 26.

THE WITNESS: Exhibit 26, thank you, demonstrates the large sums that would be made available to ADCNE cooperatives relative to that paid earlier. Yet, there is very little required of the group in the way of specified performance services to be rendered in return. While the proposed order language does contain provision that recipient may be the first enlisted to meet any increase in milk shipping requirements established under a “call” by the Market Administrator, it doesn’t go far enough, in our opinion. Recipients don’t have to meet a higher shipping performance standard in the fall months when milk is needed most. In fact, they can sell almost unlimited milk to the southeast or to other markets; irrespective of the needs here.

We think a higher shipping standard would be appropriate for recipients to “earn” in return for the direct payments received from pool funds. Service payment recipients should have to answer to a higher standard to assure that the priority needs of Order 1 fluid milk handlers are fully met. At minimum, recipients should be required to meet the increased shipping requirement proposed by New York State Dairy Foods, Inc. in Proposal number 3 submitted at this hearing. In addition, recipients should be required to provide “waiver” in ~~fully~~ **full** supply agreements with manufacturers enabling milk to be diverted for fluid use, if needed in the fall qualifying months. Such requirement used to be provided in the New England Federal Order.

We also question whether a “recipient” should be entitled to charge a fee to another cooperative for the “privilege” of guaranteed “full pooling” in the umbrella 9 C unit operated by larger cooperative collecting marketwide service payments. The problem, with such pooling arrangement, from our perspective, is that it gives strong incentive for the smaller co-op to ~~know~~ **become** a “reluctant dragon”, when pressed by the larger one or other handlers to furnish milk to the primary fluid market. If the reluctant supplier is fully covered for pool qualifications purposes, why release any milk? They may not want to, unless required **to** by the ~~Other~~ **Order** or paid a spot milk price sufficient for them to do so. It doesn't make sense to draw pool funds for so-called balancing services--on milk made difficult to release to the fluid market sector. Moreover, it adds insult to injury, if the larger co-op collects from both ends of the spectrum-from the pool for marketing services and from the smaller cooperative "payer" for pool qualification. This situation is but another example of "double dipping" for funds, which should not be authorized under Proposal 7, in our opinion.

Finally, we are concerned that the "service payments" might tempt handlers to "ride" the northeast pool by withdrawing large volumes of pool milk to southeastern orders in the fall and re-pooling the milk in Order 1, December through June. Proposal 7 provides the means to "double dip" for pool payments from both markets. This leaves producers in Order 1 the dubious privilege of carrying the reserve supply from other Order markets.

Thank you, this concludes my statement on Proposal 7.

JUDGE BAKER: Mr. English.

BY MR. ENGLISH:

Q Mr. Arms, just, beginning where you left off, do you have personal experience with respect to balancing the Southeast Market on Order 1 with respect to facilities

with which you are aware? Did you this summer have any ~~--~~
– **personal experiences.**

A Yes, I think you are referring to the situation where on behalf of some milk handler clients, I tried to find room at various manufacturing plants, one of which was the Dietrich's operation with which I was formerly associated. I was informed that there was no room for any northeast milk. Paid milk from our plant. And I also learned that the plant was pretty full ~~--~~– **there really** wasn't very much room at the end. However, an awful lot of that milk that was in that plant was milk that was being run north from the DFA south into the Dietrich's plants. So, this balancing ~~plan~~ **plant** was not available to the ~~Northeastern --~~– **Northeast for fluid use**.

Q You heard testimony earlier and, in fact, it is in the record, exhibits, that Upstate Cooperative is both an eligible entity for collecting, assuming these payments are instituted, and also operates Class I operations. Does that raise any concerns with respect to your statements, for Class I with respect to your statements about how this might impact on Class III or Class IV manufactured products?

A I, I believe we have to be concerned where cooperative draws, cooperative service ~~paying~~ **payments** is also a fluid milk distributor at the same time, which Upstate is. I believe it is the only one in the ADCNE ~~fluid~~ **that** is, not that this necessarily happened, however, because there are no restrictions on use of cooperative payment monies, funds could be used that would result in a competitive problem from other, with other handlers with whom Upstate does compete.

Q And some of those other handlers are members of the New York State Dairy Foods Association for which you appear today?

A Either members or in support of this statement, one of which is the Burn Dairy, non-members.

MR. ENGLISH: Thank you. The witness is available for cross examination.

JUDGE BAKER: Thank you, Mr. English.

Are there any questions for Mr. Arms? Yes, Mr. Beshore.

MR. BESHORE: Thank you, Your Honor.

CROSS EXAMINATION

BY MR. BESHORE:

Q Good afternoon, Dave.

A Good afternoon.

Q Can you list for me the nine C cooperatives who are members of New York State Dairy Foods, Incorporated?

(Pause.)

THE WITNESS: The extent to which the handler list, I would say the great majority are not 9 C handlers themselves. As to whether or not one or two of these handlers, cooperatives, I am not aware. So, I guess I will answer your question I don't know.

BY MR. BESHORE:

Q   You don't know if any of the members you are speaking for are 9 C cooperatives?

A   I know that there are cooperatives, some cooperatives or a cooperative, that is a member of the Association, but I don't see it listed there.

BY MR. ENGLISH:

Q   Okay. Well, again, the list is those who signed on in support of this testimony, correct?

A   That is correct.

BY MR. BESHORE:

Q   Okay. So, there are no 9 C cooperatives on whose behalf you are testifying today, correct?

A   I don't see any, Marvin.

Q   I didn't see any either, but I thought maybe you could tell me something about a list that I didn't see.

A   Well --

Q   You can't?

A   I think your assessment is correct.

Q Okay. Can you tell me, your brokerage business, Berkshire Dairy and Food Products, do you have clients that are 9 C cooperatives?

A I am attending and participating in this hearing not as an employee of Berkshire Dairy and Food Products, although I am.

Q I understand.

A Okay.

Q And the question was does Berkshire Dairy Food Products have clients who are 9 C cooperatives?

A Yes.

Q I just wanted, you expressed a lot of concern for 9 C cooperatives and none whom are members of the Association, and I gather they are clients of your brokerage company.

A You are mistaken in your, I believe, Marvin, let me explain. The statement presented on behalf of fluid milk handlers. So, I didn't state, **this was** presented on behalf of 9 C cooperatives.

Q I understand that. But, it addresses, apparently, concerns with respect to, you know, the competitive circumstances of 9 C cooperatives.

A Yes. No, concern of the fluid milk handlers.

Q For the welfare of 9 C cooperatives.

A The table reflects a growing market share of cooperative 9 C milk. It is more than 80 percent, much beyond the total cooperative membership and this is a cause or concern of what that can lead to in the competition.

Q Okay. You know, the market list ~~also~~ **for this data** reflects an increasing number of independent dairy farmers in Order 1. Have you noted that?

A I have shown here in Table 2, I think it is, a total independent producers and their market share. However, Marvin, in those columns, the independent and the cooperative membership add together, 100 percent total milk, however, in terms of 9 C, you have to extract a ~~---~~ **very significant volume** of independent milk over into the 9 C column.

Q Okay. Now, are you aware that Proposal 7 excludes from payment to qualifying cooperative handlers if they happen to be ~~---~~ cooperative, independent producers, independent milk, from the pool report? Are you aware of that?

A My understanding of this Proposal 7 you can exclude the so-called independent producers from qualifying into the cooperative service payments, but would not disqualify smaller cooperatives who might come into the larger 9 C --

Q You noted that in your Table 2, Exhibit 26, total 9 C milk as Peter Fredericks testified, includes some milk of independent producers.

A Absolutely.

Q Okay.

A Absolutely.

Q But, just so we are clear. You understand that the cooperatives pooling that independent producer milk would not be entitled to any marketwide service payment on the milk volumes under Proposal 7?

A Yes, I do.

Q Okay. You, you have been around the dairy business a number of years, Dave, and I am sure you would agree as everyone else has, I think to date, that balance, providing balancing services to the Class I market costs money, correct?

A There definitely is a cost to balance, yes.

Q And you agree seasonal, seasonal balance is required as Dr. Ling indicated, correct?

A Without reference to Dr. ~~Ling~~ **Ling's testimony**, I am -- to say yes, there are added expenses, particularly if the milk is, a lot of milk is drained out of the order to elsewhere.

Q Well, regardless of where --

A That makes it very costly to our members.

Q But, regardless of where the milk comes from to satisfy your fluid handlers needs for milk, somebody has got to tailor their supply to their needs if there are seasonal conflicts between fluid demand and the production of milk, isn't that correct?

A I am not going to exactly agree with your premise, because the ability to service needs in fall months doesn't always, doesn't necessarily mean a cost and actually may mean a very high return, depending on the spot price charge for such balancing. So, no, I can't agree with your premise.

Q That it costs the supplier, if somebody incurs a cost to balance seasonally, you disagree with that?

~~A~~ **Q** Well, ~~if~~ you ~~had~~ **just** said ~~you pay~~ **they get paid** for it, perhaps~~.~~**?**

A You ~~can't pay~~ **get paid** for it there, and also as has been testified and I refer to in my statement, that as far as processing into manufactured products, ~~is~~ **it's** the role of the class pricing system to make sure that those costs are covered.

Q So, all producers get the same blend price in the market, and in your opinion, they all get the same blend price, right?

A Yes.

Q Okay. They have got different costs, but, that compensates everybody equally in the market, right?

A Wait a minute. No, no, producers do not always get the same price.

Q ~~I say~~ **The same** blend price.

A No, they --

Q ~~--~~- **The same order** minimum price.

A They get the minimum price but not necessarily the statistical uniform price because it may vary tremendously by virtue of the components of their milk and the market to which is ~~---~~- **delivered** because under the new order, the milk is priced at the point of first receipt and you can get tremendous variation in payments to the producers, although in a uniform, in a uniform may establish, but, depending on how the milk is moved, it can be consulting very grave, their ability, and this would be particularly true if a handler has the cost of milk to move backwards against the zones.

Q As Mr. Gallagher testified?

A Yes.

Q Okay. And that is cost of balancing that market.

A ~~-- the same~~ **It is a** cost to producers ~~this~~ **whose** milk ~~and~~ **can be moved** around that way, yes. That is assuming that the producers actually suffer that extra cost. And in some instances, I am aware where handlers are moving some milk where they absorb the costs. And they don't, ~~almost~~ **always** have to under the Order, but they do.

Q Okay. Well, producer who delivers to Burn Dairy 365 days a year, don't have any of this cost, so it doesn't --

A That is not true. I am aware of balancing costs for Burn Dairy that have, they have had extensive balancing costs on their milk.

Q Burn Dairy has?

A Yes, Burn Dairy.

Q ~~Do they -- same~~ **Are they 100 percent** ~~independent supply~~ **independently supplied?**

A No.

Q Are they, who balances Burn Dairy?

A That is proprietary information.

Q Is that a supply that **you** broker?

A Fully? No.

Q Okay. You, you say that Proposal 7 did not provide payment to some who are performing valuable balancing services for the fluid market, and could do more balancing if they had the regulatory tools and incentives to do so. By regulatory tools and incentives, are you talking marketwide service payments?

A There may be some proprietaries that could qualify if the rules were changed to have them qualify. But, that is not what I am referring to really in my statement.

Q Well, you are saying that some, some parties do not do balancing now but could do or do some, but could do more if they were given the regulatory tools and incentives to do so. What, what are you referring to, what regulatory tools and incentives would be appropriate to induce these parties to do more balancing?

A I was thinking at the time on the ~~---~~ **clients** that I have, which has the proposal **contained in the** ~~supplement -- and supplement~~ **supplemental** hearing notice here ~~---~~ ,**namely the HP Hood Company.** which does, in fact, have some capacity in their plant that could be used, but which the order discriminates against them and based on the ~~human~~ **unit** pooling provision which we propose to amend. That ~~plan~~ **plant** could have been used extensively to help balance the market.

Q Okay. I assume we are going to discuss some things about that ~~---~~ **plant when we get to your proposal.**

A The -- other handlers that might, could have.

Q It is not profitable to do it now.

A In the case of a ~~--~~- **milk** company, as I mentioned, the regulatory tools are not available to them fully. They are willing, the handler is willing, the order is unwilling.

Q Well, they can buy milk at whatever the market will bear and condense it now, resell it as condensed product, can they not?

A No, the order assignment rules ~~disclosing~~ **discriminate** against the handler on their fluid sales, their Class I sales cause them under the ~~--~~- **unit-pooling** rules, which I will testify to, discriminated against.

Q Do you, when you call for a national hearing on marketwide service payments, is that because you are in favor of marketwide service payments on a national basis, your New York State Dairy Foods?

A No, I feel I ought to say --

Q You would be against it whether it is national, regional or whatever, isn't that the case?

A No, some of my best friends are cooperatives. They belong to cooperatives. I spent much of my career with cooperatives.

Q ~~--~~- **You understand this** isn't a cooperative service payment proposal, or do you?

A If it quacks a like duck, swims like a duck, I think it is a duck.

Q So, you think it is a cooperative service payment.

A What, Proposal 7?

Q Yes.

A Yes, it is a payment to cooperatives without any restriction.

Q Isn't that right?

A -- one ~~---~~ **they** should answer a call, if initiated.

Q That would be --

A **It would give** ~~P~~priority to the ~~conditions~~ **needs** of the market. I believe and knowing several of the cooperative players, I believe that they will be responsive for the most part.

Q But --

A But, the order doesn't require **them** -- You asked me one question, and I didn't adequately answer, and it is important.

The Federal Order now provides Class III and IV pricing such that ~~in and when~~ **any plant** in the Federal order system regardless of where it is, is charged the same Class III and Class IV price. And all I am saying is, it doesn't seem appropriate to us to have a system that rewards, ~~wholly~~ **only** Northeast manufacturers.

Q But, would you support Proposal 7 if it were part of the national --

A But, it wasn't, no, that was not my testimony.

Q No. But, I am asking you, would you support it?

A No.

Q You wouldn't support it regardless, would you?

A Well --

Q National regional ~~area~~ **or anything**.

A Don't put words in my mouth.

Q I am asking you a question.

A The question, the answer is I would have to see what that provides. I don't see anything currently to render such an opinion.

Q If Proposal 7 were a national proposal, when you see Proposal 7 --

A There are other problems that I ~~invest~~ **address** in my statement in regard to the merits of Proposal 7 that would mitigate against it were it a national.

Q Okay. If three million, if one million **a day** or three percent is not the right size, what is the right size, that you would support?

A I am not prepared to testify to that. I think that you, **the ADCNE group** as proponents that it is incumbent upon you to make that available.

Q Well, when you tell the Secretary, testify in this record, that there are balancing cost, important valuable balancing services but that the qualification criteria aren't appropriate, it is incumbent upon you to perhaps indicate what in your view might be appropriate.

MR. ENGLISH: Your Honor, I believe the testimony was asked and answered, what he says about size is not important. And I think the witness has already answered the question and now we are getting argument, which probably we were doing 16 hours ago, but.

JUDGE BAKER: Thank you, Mr. English.

Mr. Beshore? Do you have a question pending?

MR. BESHORE: I do.

JUDGE BAKER: About the size.

MR. BESHORE: Yeah, what size he would support.

JUDGE BAKER: If he would support any size.

MR. BESHORE: If he would support any size.

(Pause.)

JUDGE BAKER: -- make that question --

MR. ENGLISH: I did not instruct him not to answer.

JUDGE BAKER: Pardon me?

MR. ENGLISH: I did not instruct the witness not to answer.

JUDGE BAKER: All right, thank you, Mr. English.

MR. ENGLISH: ~~---~~ **I would** point out these terms of art.

JUDGE BAKER: Very well, thank you.

THE WITNESS: I believe the balancing function is not restricted just to the ~~---~~ **mega-size** cooperatives. I am aware of some smaller cooperatives who do balance for their fluid customers, and who have seasonal variation in their receipts. And do the same thing your team is doing, at a cost, some months of the year and have advantage in other months of the year.

BY MR. BESHORE:

Q You have made the contention, at the bottom of page eight, your testimony that the Proposal 7 would tempt handlers to ride the northeast pool by withdrawing large volumes of pool milk to southeastern states in the fall and re-pooling the milk in Order 1, December through June. I assume, you probably drafted this before you heard Mr. Wellington's testimony about the language that has been proposed to be added to make it not possible to flip flop milk back and forth between borders in the southeast and **Order 1 and** draw payments, you heard, am I correct?

A I did hear and with all due respect to Mr. Wellington, I consider -- I do not think it applies in all instances, for example --

Q You think three months is not long enough?

A No, but, the rule I believe he is referring to is where milk is shifted to the other orders. That, I am saying that if milk is transferred or diverted, it could be diverted during August through December, ~~and~~ **when** we need the milk for fluid handlers, it can ~~drive ---~~ **draw the cooperative service** payment, even while it is being withdrawn and then the milk can come back, usually around December 24. And it can stay in the Northeast order, the entire period, December 24 through July, at the expense of the very producers that are, who are going to have to pay the marketwide service payments because they are carrying the reserves of the other market in most circumstances. And I believe that still would apply.

Q Well, in the fall months, are you saying milk is still pooled on Order 1, but being transferred, pooled on Order 1, it is being shipped south to Class I markets and the Class I utilization is in Order 1, correct?

A Yes, sir.

Q And you have a problem with that?

A I don’t, let me put it this way. I understand that the function of a cooperative is to seek optimum returns. So, I understand that.

Q Well, you understand the --

A But, if the milk, too much of the milk is shifted out of the market, and needs arise for the fluid milk handlers in the northeast, what I am saying is the northeast handlers should have the priority on it and not have to suffer huge increases in their spot milk -- ~~changes~~ **charges** to make a difference --

Q The milk that is pooled in Order 1, that has Class I utilization, whether it is shipped to the south or to New York City, the blend price, that Class I utilization, the blend price goes to every producer in Order 1, does it not?

A That is correct.

Q Okay. And so, you have a problem with that because, well, have you had any, have any of your members not received the milk they needed last fall on Order, you know, Order 1 because if there was no milk, enough milk?

A We have a proposal in this hearing to increase the pooling requirements for that very reason.

Q Because they didn't receive enough milk.

A They were not able to receive enough. Not without considerable payment.

Q They had to pay for it. Is that it? Is that the ~~---~~ **payment?**

A Not just price, but availability as well.

Q So, when ADCNE cooperatives have deliveries in ~~the number~~ **November** of more than 10 million pounds a day above their low point in May, had additional deliveries to seven A plants, your members in November, that was, they really should have been delivering more than that, is that your request?

A My statement has not attempted to quantify that amount, beyond the scope of my testimony.

Q By the way, do any of your members distribute fluid milk products that are processed in an Order 1 distributing plant in the area, fluid milk products to customers beyond the geographic confines of Order 1?

A I have not made an analysis, but knowledge of some of the handlers, suggests that you are correct, there are large handlers who have large areas of distribution beyond the Northeast.

Q But, they are located in the northeast, they are pooled in the northeast and they require supplies of raw milk to package that product from the northeast, correct?

A Correct.

Q Okay.

MR. BESHORE: Thank you.

JUDGE BAKER: Thank you, Mr. Beshore.

Are there other questions for Mr. Arms? Let the record -- Did you have any, Mr. Tosi?

MR. TOSI: Yes, Your Honor, I have some. I needed to consult with, with the Market Administrator.

CROSS EXAMINATION

BY MR. TOSI:

Q Mr. Arms, on the bottom of page four and the top of page five of your written statement, would it be accurate to say that, that what you are suggesting here is that the, if the Department should adopt Proposal 7, that that would have the effect of using the order program in some way to promote cooperative marketing the milk?

A Yes, and I think it would, it goes to the heart of my calculations on market share. I think it would raise the increased market share. Larger 9 C units.

Q And to the extent that at least in **the old** New York and New Jersey Order, there was specifically was provided in the ~~marketwide~~ **cooperative** service payment, was it your understanding on that whole provision that is one of the reasons it was there was also to promote cooperative marketing of milk?

A Definitely to promote cooperatives, promote marketing and promote marketing within the larger cooperatives.

Q And for the duration of the, for the ~~lack~~ **life** of the old New York, New Jersey Order, that provision had been there for many, many years?

A Yes, it had been there many years, but we have to be careful not to compare apples and oranges.

Q I appreciate that. I guess what I am asking is is that to the extent that the New York, New Jersey ~~provide~~ **provided** the payments specifically to co-ops to, in part, promote co-op membership and, and co-op marketing of milk, the New York, New Jersey market never even reached a point where two thirds of the membership was cooperative, that there was such as a large number of, continued to be such a large number of independent milk. And in light of that, and comparing that to your statement here, could you explain for the record how, how one would accomplish something that another provision that was specifically intended to do that, couldn't?

A Happy to.

Q Pardon?

A Happy to.

Q Okay.

A In my work in the New York, New Jersey **Order**, having come from New England, I was impressed by the great difference in cooperative membership in New England versus

~~in~~ the New York **market**. In working with those cooperatives, I discovered the reason, now this is my own opinion, but, number one, they had farm ~~towns~~ **town zone pricing**, and number two, they didn't have in that order a 9, a so-called 9 C, and we had 9 B in New England, and New York, New Jersey market is farm ~~--~~- **point** pricing. And I realized early on that the marketing service payments in New York were failing. And they failed to bring about increased membership, because, because **the co-ops** competed and fought with one another over membership, constantly. And some of their basis for these conflicts involved achieving a unit large enough and efficient enough which could be co-mingled, let's say, with another party's milk in order to maximize the efficiency from their milk. So, the in fighting among the co-ops, as I experienced it, particularly while I was at NEPCO, was counter productive in the basic purposes of the provisions.

Whereas, in New England, at plant ~~going~~ **point** pricing, and didn't have the same incentives for co-mingling milk, the cooperatives on that side have right to membership. Some of it being management inspired, maybe. Now, why are, why are we concerned now? The difference is the cooperative 9 C provision in the **New**

York Federal Order 1, refers specifically to milk for which the cooperative, **cooperative is** the handler, and they can achieve this ~~---~~ **simply by buying milk**, and hence, that is the ~~---~~ **great difference.** I hope it explains.

Q   And correct me if I am wrong, the other thing that I think I heard in your testimony is, is that there is something unique about ~~---~~ **plant point** pricing versus ~~---~~ **farm point** pricing **that** played a role here? Is that --

A   Yes.

Q   All right.   Also, on page six of your testimony, in the first, excuse me, in the second full paragraph, you express concern about how the co-ops that, that would receive this compensation from the pool, there is some concern that you express there on how a co-op would use the funds.

A   Yes.

Q   In your experience, has the Department ever concerned itself with how a cooperative decides to, what they decide to do with the money that it gets, that it receives from those that they sell milk to?

A   Sir, I missed --

Q   In your experience, are you aware of any instances where the Department has ever concerned itself with how, with what co-ops do with the income that they receive from selling milk or any payments that they ~~--~~- **receive.**

A Yes, I do know and I think I referred in my statement that the cooperative service payment provision in the New York, New Jersey Order did carry some specific performance standards. For example --

Q Well, there were criteria.

A There were criteria.

Q **Given** ~~C~~**c**riteria on that, and the co-op receives money.

A Yes.

Q Or is paid or whatever that source of income is, that, that happens as a result of ~~--~~- **the existence of the Federal orders**, has the Department ever involved itself with how they are spending money?

A Definitely. And I will speak to that, because one of the requirements under the old plan was that you had to have an economist. That provided me ~~--~~- **employment**. And in addition, another requirement was that they had to have in-house or outside legal counseling. And, and they had to do a report at the end of the year, outlining everything that the co-op did with those monies for the benefit of all producers. And I know this, I know this because I had to prepare such a report.

Q Okay. Still, I understand all that, but, it is because the criteria was met and ~~reserved as~~ **there is** a similar criteria, excuse me, I don't want to say that the criteria is similar, that criterion exists, ~~isn't that what~~ **if met would** cause something to happen, just as it did in the old New York, New Jersey order?

A I am sorry, but, I don't follow that in Proposal 7. I don't see any restriction with what they **can** do with the money. I think they can use that money to go out and solicit ~~---~~ **members**. I ~~simply see no ---~~ **think there is no prohibition** whatsoever. I see that they can use that money to go a smaller co-op, come join with us and we will share the proceeds.

Q So, in your opinion then, money is being received in, in your testimony, **you maintained** even though it is not earned?

A ~~Don't know~~ **Maybe**, but, there is nothing in the proposal that is specific about how they should ~~---~~ **earn it.** That is our objection.

Q To the extent that the cooperative is able to negotiate the ~~milk order payment~~ **over-order premium**, that is not ~~---~~ **earned** in the sense that in the way we are talking about earning something, has the Department ever concerned itself with what ~~is called low order~~ **a co-op does with it's over-order** premium money?

A Yes. I have received calls, for example, what are you paying now for milk and so forth. And I know they analyze that and they analyze how, how the party is handling their purchase of the milk. And so, they are concerned. I think they are doing their job. And frankly, I am not saying **that** the cooperatives aren't their doing their job in meeting these -- I know from personal experience, with many years with the cooperatives, that they frequently do. But, I am also aware that they don't.

Q Okay. Would you agree that the cooperatives are provided the freedom to not pay their members the blend price?

A Under the ~~---~~ **Capper-Volstead Act** I believe, at least it always been my training, that by virtue of a vote by the board of directors, that ~~impose~~ **approves** a payment to their owners and they have the right to pay any price to their members that the total returns can dictate, if they are -- And ~~yet you relate it to this~~ **it's related to this**, the funds that they have available. And so, from time to time, when a cooperative gets in distress, they do have **re-**blends and we cover some losses that way. And, again, my experience with NEPCO is very pronounced in that.

Q And then to the extent that the, well, the total payment for example **a** for hundredweight **of** milk is largely the blend price and the co-op doesn't have to pay that to its members, would you find it odd ~~though~~ **then** that, to, to be recommending to the Secretary that to the intent that we, that the Department is not ~~involved~~ **involve itself** with what it pays members, but that we should somehow be very involved with how they are spending other money that they are able to extract from the marketplace?

A What a cooperative proposes to do with monies they earn in the market is one thing. What they do with monies that are taken from other producers, not other than membership, is another. And so, if they have unlimited use of funds, unrestricted in any way, shape or manner, then that could be ~~--~~– **abusive** to others **who are** not collecting the ~~marketing~~ **cooperative** service payments. That could be cooperatives as well as ~~--~~– **independents**.

MR. TOSI: Okay. Thank you. I appreciate it.

JUDGE BAKER: Thank you, Mr. Tosi.

As I indicated earlier, we will take a break every couple of hours and a couple of hours has expired. So, we will take a break.

MR. ENGLISH: Could we first see if there are any other questions for Mr. Arm?

JUDGE BAKER: I will ask. Are there any more questions for Mr. Arms? There appear to be none, then.

MR. ENGLISH: Thank you, Your Honor.

THE WITNESS: Thank you very much.

(Whereupon, the witness was excused.)

JUDGE BAKER: Well, Mr. English, are you --

MR. ENGLISH: We would move admission of Exhibits 24, 25, and 26.

JUDGE BAKER: Very well. Are there any questions, or objections to them? Hearing none, Exhibits 24, 25 and 26 are hereby admitted and received into evidence.

(The documents referred to, having been previously marked as Exhibit 24, 25, and 26 were received in evidence.)

MR. ENGLISH: Thank you, Your Honor.

JUDGE BAKER: You are welcome.

(Whereupon, a short recess was taken.)

JUDGE BAKER: The meeting will come to order.

Mr. English, there are no additional questions of Mr. Arms, do you have any other witnesses?

MR. ENGLISH: Oh, yes, yes. The next witness is Mr. Donald Gilman.

JUDGE BAKER: Very well.

MR. ENGLISH: Of Middlebury Cooperative Milk Producers Association.

JUDGE BAKER: Mr. Gilman, please step forward, please.

MR. ENGLISH: He has a very brief statement. A copy, I think for himself.

JUDGE BAKER: All right.

Whereupon,

DONALD GILMAN

having been first duly sworn, was called as witness herein and was examined and testified as follows:

DIRECT EXAMINATION

BY MR. ENGLISH:

Q Mr. Gilman, would you state your full name for the record?

A Donald Eugene Gilman.

Q And you are appearing today both on your own behalf as a dairy farmer, and also on behalf of Middlebury Cooperative Milk Producer Association?

A Yes, we are.

Q Why don't you give your brief statement, I have a few more questions for you.

TESTIMONY OF DONALD GILMAN:

MR. GILMAN: Okay. I want to thank you very much for the opportunity to come here today.

My name is Don Gilman. I am dairy farmer and president and general manager of Middlebury Cooperative Milk Producers Association, Incorporated. Middlebury Cooperative is located in North Central Pennsylvania. And we market milk from 100 dairy producers located in New York and Pennsylvania. Our cooperative performs marketing field service, member payments, reports, and we qualify as a 9 C cooperative. We balance our supply through our daily sales to our various markets.

I would like to make a few comments on Proposal Number 7, marketwide service payments.

There is a cost of balancing and it is no exception for Middlebury Cooperative. Our market returns vary greatly due to balancing. As our costs increase, our net member payments decrease. Under this proposal we would not qualify for co-op payments because we are a small cooperative business with low volume. But, we still perform this vital function for our customers. If this proposal passes, we could suffer further cost increases, which would still have our, would cost us still, if the proposal passes we would suffer further cost increases.

We would still have cost of balancing and a monthly price with a further four to six cent reduction. This would in turn reduce our producer premiums which we definitely do not need.

I am not completely opposed to marketwide service payments, but I am opposed to qualification requirements for those payments. I feel that small business and large businesses alike should be compensated equally for their performances of these functions, that could then benefit all producers in the Order.

BY MR. ENGLISH:

Q Mr. Gilman, thank you for coming today.

Do you understand that under the rules of which we work for these proceedings that dairy farmers are defined as small businesses to the extent their income does not exceed $750,000.00 a given year?

A Yes, I do.

Q Are you, would you qualify as a small business, your farm?

A Definitely, very small.

Q And the other approximately 100 dairy farmers, who are members of Middlebury Cooperative Milk Producers Association, they also qualify as small businesses?

A Yes, they would.

Q And they would all be adversely affected by adoption of this proposal?

A Yes.

Q Now, there was some questions asked of the previous witness that elicited testimony that ~~half of them~~ **happened to** ~~mentioned~~ **mention** your co-op's name, do you remember that?

A Yes, I do.

Q Without disclosing, if that is your desire, then names of your customers, can you tell me approximately how many customers Middlebury Cooperative has?

A Through the year or month?

Q Well, does it vary?

A It varies. Somewhere between, say eight, 15 maybe.

Q Do you tend to sell more milk to Class I market in the spring or fall?

A Usually in the fall.

Q And how have you managed to sell more Class I milk for the market in the fall? What do you do with your milk in the spring?

A The other markets we have are normally Class III markets. And we do pull it from those markets to help balance the Class I markets that we sell to.

Q And to that extent, those Class III customers pay you what you have been able to agree on receiving in the flush months, is that correct?

A The, say that again?

Q If you, to the extent that you receive a price for your milk on, with the Class III products, you are somehow adjusting your prices in order to take it away from the Class III manufacturing in the fall, correct?

A Oh, definitely, yes.

Q And in that fashion your cooperative pays for your own balancing, correct?

A Yes, we do.

(Pause.)

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

JUDGE BAKER: Very well, thank you, Mr. English. Are there any questions? Yes, Mr. Beshore?

CROSS EXAMINATION

BY MR. BESHORE:

Q Thanks, good afternoon, evening, Don.

A Good evening.

Q Approximately what is your monthly, your monthly volume of your milk?

A Again, that varies on --

Q On average?

A -- seasonality. Somewhere between 10, 15 million, maybe.

Q Would you say your producers are probably about average size for the order?

A They are the ~~major~~ **majority**, yes, they are.

Q Do you have more than one Class I ~~count~~ **account**?

A Yes, we do.

Q And approximately how many Class III customers?

A Oh, five or six.

Q Would you, would you agree that the way you balance, you don't own any manufacturing plants, correct?

A Pardon me?

Q Your cooperative does not own any manufacturing plants, correct?

A No, we don't.

Q So, on a smaller scale, do you balance your Class I customer supplies essentially the way Mr. Gallagher described that Dairylea does by sales to other plants they don't own?

A To other plants, right.

Q So --

A Usually at the reduced rate.

Q At a reduced rate.

A Right.

Q That is your cost of balancing, that you indicate.

A Pardon me?

Q That is, that makes up the cost of balancing that you testified to, correct?

A Yes.

Q So, as I understand, you would not qualify under Proposal 7 as in the hearing notice, because you don't, you don't have a million pounds a day?

A That is true.

Q But, otherwise you would, meet the qualifications, I would expect.

A We don't have one third of the order, we don't have a plant.

Q Right.

A And we don't sell, I shouldn't say, 65 percent to Class I at certain times of the ~~---~~ **month** on a regular basis.

MR. BESHORE: Okay. Thank you.

JUDGE BAKER: Very well. Are there other questions for Mr. Gilman? Let the record show that there are none. Thank you very much, Mr. Gilman.

(Whereupon, the witness was excused.)

JUDGE BAKER: Mr. English?

MR. ENGLISH: The next two witnesses, the last two witnesses will testify primarily on Proposal 7, but as they are also operators of the plants, they need to get back there -- No, I am sorry, Mr. Buelow will testify on Proposal 7.

JUDGE BAKER: Very well.

Whereupon,

JAMES BUELOW

having been first duly sworn, was called as witness herein and was examined and testified as follows:

MR. ENGLISH: Your Honor, I have handed the court reporter four copies and yourself a copy of a two page statement that is Mr. Buelow's statement. May I have it marked?

JUDGE BAKER: It should be marked for identification as Exhibit 27, Mr. English.

(The document referred to was marked for identification as Exhibit 27.)

DIRECT EXAMINATION

BY MR. ENGLISH:

Q   Mr. Buelow, could you state your full name for the record?

A   James Buelow.

Q   And could you give me just a, a brief history, why don't you give your statement, please.

A   Okay.

TESTIMONY BY MR. BUELOW:

THE WITNESS: I am employed by Worcester Creameries Corporation. My office address is Box 249, 2 Railroad Avenue, Worcester, New York 12197. Worcester Creameries Corporation is the purchasing arm of the following sister companies: Elmhurst Dairy in Jamaica, New York, Mountainside Farms in Roxbury, New York and Steuben Foods in Elma, New York. These companies are wholly owned by the Schwartz Family. Elmhurst Dairy and Mountainside Farms are primarily fresh fluid milk plants and Steuben Foods manufactures many food products including extended shelf life milk products. Worcester Creameries Corporation purchases milk from its own independent farmers as well as from cooperatives. I am testifying today on behalf of the previously stated companies and New York State Dairy Foods and its supporters in this hearing.

My career in the dairy industry spans more than 35 years. I was the owner operator of a dairy farm in the Northeast from 1966 to 1987. I was employed by the National Farmers Organization 1983 to 1999. While at the National Farmers Organization I held many positions including Director of Marketing in the former Federal Orders of 1, 2, 4, and to a lesser extent of 36 and 33 and surrounding areas.

My current responsibilities include the

purchasing of all fluid milk supplies for the previously mentioned milk plants. I also oversee the accounting for all fluid milk supplies and am responsible for the filing of all State and Federal Milk reports for our companies.

Proposal 7, Market Service Payments.

Worcester Creameries and its sister companies are opposed to the proposal by ADCNE regarding market service payments.

One requirement to qualify to receive market service payments is that a handler can not deliver more than 65 percent of its pooled milk supply to a pool distributing plant. This requirement automatically disqualifies our company even though we have the ability to balance at least some of our supply. Please let me explain. Our plant in Elma, New York produces Class I and Class II extended shelf life products. These products do not have to be manufactured on a given day. Because of their nature they can be produced, to a degree, when the supply is available. However, because our primary business is fresh fluid milk and due to the fact we never need to ~~diver~~ **divert** 35 percent or more of our supply of milk, we are automatically disqualified. We are also disqualified because our balancing plant in Elma, New York is outside the marketing area **and also because it produces our own class products**.

As I stated earlier, I am responsible for the purchasing of our entire supply of milk. Over the **last** three years that I have had this responsibility on a number of occasions I have called the cooperatives **who** would qualify for these proposed payments and asked for their help in receiving some excess milk that I had on a given day. On many occasions they have said they had no room at any price. My own plants or other plants that would not qualify for these proposed payments have then ~~met~~ **had to meet** my balancing needs. It seems wrong that a cooperative could receive payment for balancing they can't or won't do. It also seems wrong that the proposal contains no specific performance requirements for receiving these monies.

Now, ~~that~~ **the** rest, part of that paragraph, even though it is printed there, I would propose to strike that, because it was addressed by Mr. Wellington in his changing of the proposal to a requirement of at least three months in the order before a producer is qualified.

JUDGE BAKER: You would strike --

THE WITNESS: Just strike the rest of --

JUDGE BAKER: -- down to collection payments.

THE WITNESS: That is correct.

JUDGE BAKER: All right. Thank you.

THE WITNESS: Another issue regarding balancing that doesn't seem fair is that it has always been the practice of ~~the cooperatives~~ **any handler** to charge a service fee for balancing. This service fee was meant to cover costs of the balancing plant. I see no language in the proposal that would change, to charge, excuse me, a service fees for balancing. This service fee was meant to cover the cost of the balancing plan. I see no language in the proposal that would change the service fee for balancing. Therefore, the qualifying cooperative could be paid twice for the same service.

The other side of balancing is supplying milk when the market is short. In short supply situations, I have purchased milk from the cooperatives that would qualify for payments. They have the ability to charge ~~whether~~ **what** they need to balance the market. The prices on some occasions are three to four times the customary handling charge. I respectfully summit that receiving additional ~~money~~ **monies** out of the pool or farmers' paycheck, is wrong.

The final reason that we are opposed to this proposal is that it takes money from all farmers and gives it to the cooperatives without any restrictions on how the money can be used. Particularly in times like now when prices are low, farmers tell me every day they need all the money they can get. It seems ridiculous that Congress passed legislation appropriating monies to be paid to dairy farmers when prices are low and the cooperatives propose to lower all farmers' pay prices further. How does this effect our companies? We need farmers and we need milk. If the cooperatives are allowed to use the funds collected from the pool (all farmers milk checks) to enhance prices paid to cooperative farmers, we will have to pay higher premiums to compete. Therefore, ~~being put~~ **putting us** at a competitive disadvantage.

This concludes my statement.

JUDGE BAKER: Thank you very much, Mr. Buelow.

Mr. English?

BY MR. ENGLISH:

Q Sir, you have sat here through most of the testimony, correct?

A Yes.

Q And you have heard some questions back and forth, both asked of cooperative witnesses and some of trade association witnesses concerning premiums, correct?

A Correct.

Q What, without violating proprietary information you would provide for this record with respect to premium levels paid to independent producers and to cooperatives who ~~serve the~~ **assert they are** balancing market?

A Generally speaking, the prices that we have to pay to cooperatives for milk is substantially higher than what we have to pay to independent farmers.

MR. ENGLISH: The witness is available for cross examination.

JUDGE BAKER: Thank you, Mr. English. Are there any questions? Yes, Mr. Beshore?

CROSS EXAMINATION

BY MR. BESHORE:

Q Good evening, Jim.

A Hi, Marvin.

Q Tell me a little bit about the three, three plants that are commonly owned by the Schwartz Family, which also is currently your employer, I take it.

A All four companies are, are owned by the Schwartz Company, yes.

Q Is the Mountainside Farms **plant** in Roxbury, a full plant?

A Yes, it is.

Q Are all three Order 1 **pool** distributing plants?

A Yes, they are.

Q What portion of the total supplies of ~~the~~ **those** three plants is supplied by your independent milk

producers?
A Very small portion.
Q How many independent producers do you have?
A That is proprietary information.
Q Do the independent supplies go to one or two or all three of the plants?
A On a regular basis they go to two of the plants, occasionally they go to the third plant.
Q When you say your independent supplies are **a** small portion, can you give us a percentage, approximate percentage?
A Twenty percent.
Q How many cooperative suppliers do you have for the 80 percent?
A Again, it varies from time to time, but approximately half a dozen.
Q Is one of the plants primarily supplied by cooperatives **---– that only gets** occasional **---– deliveries by independents.**
A No.
Q Okay. You are going to have help me, is there another supply to that plant?
A We have several supplies for our plants, yes.
Q Because the plants are separate, is each one a separate handler, which files a separate handler report?

Since they are separate companies, I guess, is there --

A Yes.

Q Each one is a separate handler under the order.

A Yes.

Q Can you give us any information as to the aggregate volume of the plants on a monthly basis?

A That is proprietary, but to try to, it is less than hundred million.

Q Now, if your, if your ~~our~~ own milk supplier ~~and then have~~ ,**your own independent** milk ~~supplies~~ **supply** ~~of~~ **is** ~~40~~ **20** percent of your needs, you don't, do you ever, is there ever a circumstance when you don't supply your own independent supplies to your plants?

A Yes.

Q And why would that be?

A Because we have to balance the overall situation and, you know, depending on the mix of contracts that we have with cooperatives and other arrangements, there are times where we have to divert our own milk.

Q So, in order to fulfil, if I understand you, I ask if this correct, in order to fulfil a contractual obligation you have entered into to purchase particular volumes from cooperatives, you are sometimes placed in a situation where you don't need some of your own independent milk.

A Correct. It is a matter of converting our milk or the cooperative milk, which, you know, sometimes it is one and sometimes it the other. But, in either case, it would be our responsibility.

Q I see. Okay. So, are all your, are all your cooperative contracts **for** committed volumes that you are responsible for, for handling, you know, either of some of the mark, requirements type contracts, you supply us what ~~would be ---~~ **we need.**

A There are some that are balanced and there are some that, that are specific volumes.

Q Okay. Now, the fact that you are citing, you stated two reasons **in your statement** why you would not qualify for balancing payments. One being that you never need to divert ~~45~~ **35** percent or more of your own supply. And I think you have explained that is very unlikely since your own supplies are only 20 percent of your total needs.

A Correct.

Q But, the other, you say you are disqualified because your balancing plant is outside the marketing area. I wonder if you may have misinterpreted, you know, the language of Proposal 7, which talks about operating a pool distributing plant as defined in Section 101.7(a), with regard to the location of a pool distributing plant.

Did you assume it has got to be in the marketing order?

A Yes.

Q Under the proposal. Okay.

A Yes.

Q And if the language actually doesn't, doesn't limit, that wouldn't be a disqualifying factor for you.

A Okay. I take your word for it.

Q And logically the proposal might be or would be, and in fact, is that if it qualifies as a pool distributing plant under Order 1, it is providing Class I products to the Order 1 ~~market~~ **marketing** area, as defined in the Order, and regardless of ~~what is ---~~ **where it's located.**

A Correct.

Q Okay. Now, you have got a long history of working in, you know, in the dairy business and we have known each other for quite a few years.

A Yes, sir.

Q And when you worked for, worked for ~~NFL~~ **NFO**, you talked, you referenced the fact that when you pay cooperatives over order prices, there are more than what you pay your independent producers, is that correct?

A That is correct.

Q Okay. But, now you, you are very familiar with the fact that when ~~NFL~~ **NFO** or DMS or whoever it is receives that money, they have got some expenses they have got to take care of before the money goes back to their dairy farms, correct?

A   Sure.

Q   And those expenses can be, can be quite substantial at times because of the marketing responsibility that the cooperative has for its members.

A   Sure.

Q   And so, you can't compare apples to apples so to speak when you talk about the net paid price to independent producers and the gross over order premium paid to the cooperative, which has expenses before it can pay the producers.

A   When I was referring to the difference between the cost of our independent's supply, and the cost of the cooperative's supply, as a company we also have the same similar type costs of paying our producers, having a payroll department of, of field services, of other services that producers need, plus the cost of balancing our supply. So, I was, Marvin, I was looking at that as a total of those, not just, not just the dollars and cents paid to the producer, but the total cost to our company, of our independent supply versus the total cost of the cooperative supply. The cooperative supply is substantially more.

Q How did you figure the balancing cost of your independent supply when you almost never have to divert it and you only divert it when you choose to divert it rather than a cooperative supply?

A When I choose to divert a cooperative supply, it costs the company money. And so that, whether I choose to use the cooperative supply or I choose to use the our independent supply, that is part of that cost to us, the total picture.

Q So, how much did you calculate, if you did, it cost you to balance your independent milk volumes on a year round basis? Setting aside payroll costs, accounting costs, procurement costs, all those costs with any milk supply and what does it cost to balance an independent milk supply when you have got three plants to deliver to on a year round basis?

A First, that is proprietary, Marvin. Secondly, it varies dramatically from month to month. There are some months where there is obviously no costs. There are other months where it is very high. It varies dramatically from year to year. If you look at this year compared to two years ago, the spring of the year, there is a dramatic difference and in the fall of the year, actually balancing our plant by having to buy some spot milk, that is cost. And it is dramatic. That the, the actual cost, the exact cost, as I said, is proprietary.

Q When you balance your plants with, by purchasing spot loads of milk, do you consider that a cost of maintaining your independent supply?

A Yes.

MR. BESHORE: Thank you, Jim, that is all I have.

JUDGE BAKER: Thank you, Mr. Beshore. Are there other questions for Mr. Buelow? Yes, Mr. Tosi?

CROSS EXAMINATION

BY MR. TOSI:

Q Thank you for appearing today, Mr. Buelow.

A Thank you for the opportunity.

Q Would it be fair to characterize your opposition to Proposal 7 as not so much as being opposed to the notion of marketwide service payments, itself, but, to the fact that under, as you understand it, the criteria for receiving the payment, you would not be eligible to receive the balancing?

A As I understand it, we would not be eligible. I -- My opinion on market service payments is that if there was to be such a payment in the order, it ought to be linked to some sort of performance standard for truly balancing, not linked to size of, of milk volumes handled or, or other such things. It ought to be linked specifically to performing a specific function.

Q That is your position if we should have marketwide service payments, we should factor in what you just said.

A But, overall, I believe over the years that, that the market through handling charges, service charges, premiums, however you want to depict it, is handled that cost, and I believe that is the way it should stay.

Q Okay. Your testimony indicates ~~there would be -- you paid~~ **that when you buy milk you pay** a service fee, would you please clarify is the service fee specifically, when that fee is presented to you or you negotiating these prices, is it explained to you specifically or billed to you explicitly as a charge for balancing?

A No, it is not explained that way, but when you sit down and you negotiate a contract with a supplier, you take into consideration whether it is, for example, a load of day, or whether it is a supply from a group of X number of producers. You also take into consideration whether you receive that milk seven days a week or whether you receive it five days a week or whatever. And in every case that I have ever been involved in, that is a seven day a week supply of milk is always less costly than "balance" supply.

Q Okay. When you divert milk, who ~~can~~ **do** you ~~only~~ **normally** divert milk to? You don't have to say anyone specifically --

A Yes, I can't give you the name of the companies, but it has been powder plants, it has been cheese plants. It is even with other fluid plants.

Q When you divert to just say to butter, powder plants, do they pay you class price on it?

A It depends on the time of the year. It depends on the market situation. There has been times where the net receipt is certainly less.

Q Okay. Just quickly. Your testimony, you have sister companies that are -- and should I conclude that there are five plants?

A No. There is, there is three milk plants, one in Jamaica, New York, Elmhurst Dairy, one in Roxbury, New York, Mountainside Farms, and Steuben Foods in Elma.

Q I am sorry. I miscounted, I apologize.

A Yes.

Q Do you know what the Class I differentials are that are applied to those locations?

A The differential in New York is 10 cents less than the differential in Boston.

Q That is in Jamaica?

A In Jamaica. The differential at Roxbury is 55 cents less than Boston.

Q Okay.

A And the differential at Steuben Foods, I believe is a $1.05.

MR. TOSI: That is all I have. Thank you very much.

JUDGE BAKER: Thank you. Are there any -- Yes, Mr. Beshore.

BY MR. BESHORE:

Q I was looking for your Roxbury plant on the --

A It is actually listed under the company name of Worcester Creameries.

Q Okay.

A Mountainside Farms is a division of Worcester Creameries technically.

Q Okay. That helps me find it. Thank you.

JUDGE BAKER: Are there any other questions? Apparently there are none. Thank you very much.

THE WITNESS: Thank you.

MR. ENGLISH: You will see him again.

(Whereupon, the witness was excused.)

JUDGE BAKER: Are you going to testify --

MR. ENGLISH: Yes, about another proposal.

JUDGE BAKER: Very well.

MR. ENGLISH: The next witness would be Mr. Fitchett from Marcus Dairy.

I move the admission, Your Honor, of Exhibit 27.

JUDGE BAKER: Are there any questions --

MR. ENGLISH: I thank Mr. Rosenbaum for that.

JUDGE BAKER: Are there any questions, objections to Exhibit 27? Let the record reflect that there are none. Exhibit 27 is hereby admitted and received into evidence.

(The document referred to, having been previously marked as Exhibit 27 was received in evidence.)

(Pause.)

Whereupon,

WILLIAM FITCHETT

having been first duly sworn, was called as witness herein and was examined and testified as follows:

JUDGE BAKER: Mr. English, do you want this marked?

MR. ENGLISH: yes, could we have this marked as Exhibit 28, Your Honor?

JUDGE BAKER: Very well.

(The document referred to
was marked for identification
as Exhibit 28.)

DIRECT EXAMINATION

BY MR. ENGLISH:

Q Mr. Fitchett, would you state your full name for the record?

A William Fitchett.

Q And by whom are you employed?

A I am employed by Marcus Dairy at Danbury, Connecticut.

Q Could you please give us your statement?

A Yes.

TESTIMONY BY WILLIAM FITCHETT:

THE WITNESS: What I thought I might do just so people realize who I am is read a little bit from a statement I will be giving tomorrow and then go to today's statement, if that is okay.

MR. ENGLISH: That is terrific. That is what would have happened ~~---~~ **under normal circumstances.**

THE WITNESS: My name is Bill Fitchett. I am the vice president and general manager of Marcus Dairy, located at 3 Sugar Hollow Road, Danbury, Connecticut. And president of the Board of Directors of New York State

Dairy Foods, Inc located at 201 South Main Street, Suite 302, North Syracuse, New York.

Marcus Dairy is a 75 year old independent family owned fluid milk processing and distribution business that is small in size relative to most of the players in the Order 1 market. The product is distributed under the Marcus label throughout the State of Connecticut and to the Springfield area of Massachusetts and into the Metro area of New York State, in fact more than half our sales are in the State of New York. Sixty percent of milk supply comes from independent and 40 percent comes from cooperative sources.

As President of the Board of Directors of New York State Dairy Foods, Inc., and as Vice President and General Manager of Marcus Dairy, I would like to enthusiastically support the position as set forth by David Arms, Economic Consultant regarding Marketwide Service Payments.

The Northeast Order has a large amount, 25 percent, of independent producer, non-cooperative affiliated, milk supply. The proposed amendment by ADCNE for marketwide service payments of six cents per hundredweight would reduce the pay price to these independent producers **and** to smaller cooperative producers who do not have manufacturing facilities capable of handling 1,000,000 pounds per day or three percent of the pool market.

Marcus Dairy has approximately 62 independent producers who provide about 60 percent of its milk supply. The balance of the supply comes from cooperative and other sources. There is a real recognition of **the** value of balancing supply. Class I handlers pay cooperatives fees and premiums throughout the year to provide this service. In fact, fees and premiums for Marcus Dairy have increased approximately 80 percent during the past two years.

This proposal, as written, also discriminates against small businesses that have manufacturing facilities that also help to balance the market. The criterion of 1,0000,000 pounds per day or three percent of the milk supply places the proposed fees in the hands of only the large cooperatives.

For these reasons and more, we oppose the Marketwide service payments.

BY MR. ENGLISH:

Q Mr. Fitchett, you referenced the fact that Marcus Dairy is a 75 year old independent family owned company. How many employees do you have?

A About 150.

Q So, for purposes of --– **the Regulatory Flexibility** Act, you have under 500, and therefore, qualifies small business for purpose of ~~dairy ---~~ **Dairy Programs.**

A That is correct.

Q And you also have sat here throughout the testimony Tuesday, Wednesday and Thursday, correct?

A Yes, I have.

Q And you have heard questions asked both of the cooperative witnesses and of the proprietary handlers and trade associations concerning premiums, correct?

A Yes.

Q Do you have any testimony that is not subject to proprietary concerns or proprietary concerns on that issue?

A Marcus Dairy pays premiums to both its own independent farmers and also to their cooperatives. The payments to the cooperatives are basically for handling and for balancing. In addition, we pay the cooperative fees for competitive premiums in order to secure the milk supply. The amount we pay the cooperative is substantially ~~large~~ **larger** than **the amount we pay** to our own producers.

MR. ENGLISH: Thank you. Mr. Fitchett is available for cross examination.

JUDGE BAKER: Thank you, Mr. English. Are there any questions of Mr. Fitchett? Mr. Beshore.

MR. BESHORE: Thank you.

CROSS EXAMINATION

BY MR. BESHORE:

Q Mr. Fitchett, do you have 60 percent of your supplies from your own producers and 40 percent from the cooperatives?

A Approximately, that is correct.

Q Approximately. I take it you take in the production of your independent producers, all they produce and balance with your cooperative.

A That is correct. And other suppliers.

Q Other suppliers --

A Other than a cooperative supplier, we have other balancing opportunities when we buy milk or discard milk outside.

Q Okay. Do your requirements vary on a daily and seasonal basis as has been described by other witnesses in this hearing?

A Yes, I do.

Q You have been **here** through~~out~~ the hearing, have the seasonal or the daily patterns of a supply and demand that have been depicted, generally represent, I am not talking about to the 10th of a percent or anything, generally represent the patterns that you have experienced in your business?

A Fluctuations in our Class I sales would generally appear that way. We also have some Class II sales that are more flat.

Q And in terms of daily requirements do they tend to follow the patterns that were depicted in the Exhibit 17, that Mr. Schad presented, showing the demands for, for supplies from cooperatives?

A Yes.

Q Now, your statement says the fees, fees and premiums have increased approximately 80 percent during the past two years. What, are you talking about fees and premiums to your own independent producers, to cooperative suppliers, to the other suppliers that you have alluded to? What are you referring to there?

A We have increased the premiums to our independent suppliers, but we have more than tripled premiums to the cooperative supply.

Q Tripled from what --

A Tripled from where they were, to where they currently are.

Q On a year round contractual basis, on a spot basis?

A On a year round contractual basis.

Q So what, presently over a dollar hundredweight?

A That is proprietary information.

Q Okay.

(Pause.)

MR. ~~TOSI~~ **BESHORE**: That is all the questions I have.

JUDGE BAKER: Very well. Thank you, Mr. Beshore.

Are there other questions?

CROSS EXAMINATION

BY MR. TOSI:

Q Thank you for appearing here today, Mr. Fitchett. I would like to ask you questions similar to what I asked of Mr. Buelow.

When you are paying a service fee, do they explicitly state in your contract and how it is it explained to you in some fashion that specifically talks about, we are asking you to pay more because you need to be compensated for balancing?

A In our particular situation on our total fees paid to the cost are broken down between what we call handling fees and the premiums, the competitive premiums that they need to pay their producers. The cooperative also performs a service for us, a field service for our independent farms, ship **the milk** that we have is co-mingled with cooperative supplies, picked up by them. And when we negotiated what the handling fees were, part of that most certainly talked about was the balancing.

Q Okay. Do you divert milk?

A No.

MR. TOSI: That is all I have, thank you.

JUDGE BAKER: Thank you. Mr. Beshore?

CROSS EXAMINATION

BY MR. BESHORE:

Q Just so I understand. Mr. Fitchett, so it clear your response to Mr. Tosi, the total fees and premiums paid to the cooperative that you refer to in your statement, in your case, includes field services, and other related services to your independent producers as well as the cost of the cooperative milk balancing supply, itself?

A That is correct.

MR. BESHORE: Thank you.

JUDGE BAKER: Very well. Are there any other questions for Mr. Fitchett? Thank you, Mr. Fitchett.

THE WITNESS: Thank you.

(Whereupon, the witness was excused.)

MR. ENGLISH: Move admission, Your Honor. Move admission of Exhibit 28.

JUDGE BAKER: Are there any questions or objections with respect to the admission into evidence of what has been marked as Exhibit 28? Let the record reflect that there is no response. Exhibit 28 is admitted and received in evidence.

(The document referred to,
having been previously marked
as Exhibit 28
was received in evidence.)

JUDGE BAKER: Mr. English, your witnesses are dwindling.

MR. ENGLISH: I have one more. I confess that, to my knowledge, is the last witness on Proposal 7. I did not take comfort break during the last break, because I sat back here and worked on preparing all these people so that they would, it would be as smooth as it were. So, I have, if I could have a five minute comfort break, I would appreciate it.

JUDGE BAKER: Very well.

(Whereupon, a short recess was taken.)

JUDGE BAKER: We are now in order.

Mr. Conover, would you step forward and be sworn, please.

Whereupon,

CARL CONOVER

having been first duly sworn, was called as witness herein and was examined and testified as follows:

JUDGE BAKER: Be seated, Mr. Conover.

DIRECT EXAMINATION

BY MR. ENGLISH:

Q Mr. Conover, would you state your full name for the record?

A My name is Carl Conover.

Q And would you state your as of Saturday, brand new address for the record?

A 3731 East U.S. Highway 15, Bedford, Indiana.

MR. ENGLISH: I have passed out what Your Honor has marked as Exhibit 29.

(The document referred to was marked for identification as Exhibit 29.)

MR. ENGLISH: Which is now a rather well worn CV of Mr. Carl Conover. And I apologize, I have corrected it for the number of times it has, as an expert. For speed and the fact that it is after seven o'clock, I would ask that the Exhibit 29 be admitted and I would just dub that Mr. Conover has continued to narrative his brief now as a consultant, not quite as many years as he was employed by USDA. But, I would ask both of the admission of Exhibit 29 and for his designation as an expert in milk marketing, procurement, milk marketing order promulgation, interpretation, and enforcement.

JUDGE BAKER: Without him reading the statement?

MR. ENGLISH: Without his reading the statement. I believe everyone in this room has been very familiar with Mr. Conover's career. Most of them, certainly the attorneys are and most of the attorneys in the room have stipulated to this in the past. So, I would just ask that, that Exhibit 29 be admitted and that he be so designated as an expert.

JUDGE BAKER: Very well. Is there anyone who has any questions or objections to this procedure of Mr. Conover being qualified as an expert? You want him qualified as an expert in what?

MR. ENGLISH: Milk marketing, procurement, milk marketing order promulgation, interpretation and enforcement.

(Pause.)

JUDGE BAKER: Very well. In the absence of objections, then Mr. Conover shall be considered an expert in milk marketing, promotion, promulgation and enforcement, Mr. English.

MR. ENGLISH: That was promulgation.

JUDGE BAKER: Promulgation, yes. What did I say?

MR. ENGLISH: Promotion.

JUDGE BAKER: Oh, very well.

MR. ENGLISH: He may have done that, too.

JUDGE BAKER: Very well. We will change that to promulgation, and thank you.

MR. ENGLISH: And I would also move the admission of Exhibit 29, which his CV.

JUDGE BAKER: Very well. What has been marked for identification as Exhibit 29 has been distributed around the room and is available for inspection. Is there anyone who has any questions, or objections with respect to its submission into evidence? Let the record reflect there is no response. Exhibit 29 is admitted and received into evidence.

(The document referred to,
having been previously marked
as Exhibit 29
was received in evidence.)

BY MR. ENGLISH:

Q Mr. Conover, you are appearing this evening on behalf of Dean Foods Company?

A That is right.

Q Which is both a member of the New York State Dairy Foods organization and also operates plants outside the State of New York ~~for ---~~ **in Order 1**, correct?

A Yes.

Q You have a brief statement, after which I have more questions, correct?

A I have a statement here, yes.

Q If you would please give it at this time.

TESTIMONY OF MR. CONOVER:

THE WITNESS: Congress, by passage of the Food and Security Act of 1985, provided for specific authority in the Agriculture Agreement Act for the Secretary of Agriculture to include a provision in the Federal Milk Orders for marketwide service payment to handlers who provide marketwide services that are beneficial to the entire market.

In the House Report, accompanied HR 2100, it is made clear that the intent of the legislation was to allow adjustments to the blend price to "cover the costs of pool handlers serving the food market." The preamble of Proposal 7 is consistent with that intent of the Food Security Act of 1985. It reads, "Establish a marketwide service payment to provide compensation from a marketwide pool to those who perform a service in balancing the Class I market."

Since the AMA Act requires that provision of the Federal Order, the Federal Milk Order, be tailored to meet the needs of a particular market, the fluid or Class I market of concern in this proceeding is the Northeast

Marketing area and none other. While the intent expressed is to serve only this market, the specific language proposed for Section 1001.74 is much broader.

In a market with almost a billion pounds of fluid use in a month, and the idea is to cover the costs of balancing the necessary supply for that monthly fluid use by regulating the fluid milk plants, one must come up with a reasonable estimate ~~by~~ **about** the necessary supply. There is no exact amount or percentage that would be applicable in all instances.

After taking into consideration seasonality of production and demand, daily changes in demand during the week and the impact of weather, a 70/30, that is 70 fluid use and 30 reserve, would seem to be an adequate balance. Certainly, not all of the milk in the market ~~pool~~ **pooled** as other than fluid use is a part of the necessary reserve supply.

Milk produced in areas removed from this market and pooled on an ~~opportune~~ **opportunity** pooling basis, clearly is not a viable reserve and its inclusion is a benefit to none other than those recipients of the pool, of the draw from the pool. No marketwide benefit there.

Following that same line, the pooling of local milk far in excess of the necessary reserve for the fluid market is arguably not a service to the fluid plants, nor a marketwide benefit.

Milk moves from the Northeast market on a seasonal basis, as much as 80 million monthly in the fall months. This milk is not part of this fluid, market's fluid supply and moving into another market is certainly not a part of balancing the supply of this Class I market. There may be a benefit to the, in the blend price when it moves as Class I, but the benefit for the few months would be far less than the loss to the blend of pooling the amount moved and the seasonal surplus associated with that amount as other than Class I in the other months.

Applying the suggested 70/30 ratio about fluid use we serve to the 80 million pounds moved, would indicate that there would be about 100 million pounds pooled in this market in spring to support the 80 million moved to other markets in the fall.

The act of pooling that 100 million pounds in this market doesn't make it a reserve supply for this market and diverting into manufacturing uses isn't a function of balancing the supply for this market's fluid use.

Anything that is made from the Northeast pool should be for cost of marketwide services covering this market's Class I use and the necessary reserves. And should not cover the cost of balancing other markets or milk pooled on this market, but not a viable and needed supply for this market.

That concludes my statement.

BY MR. ENGLISH:

Q Mr. Conover, is it a fair statement that Dean Foods opposes the marketwide service proposal as written in the Hearing Notice and as amended so far in this hearing process?

A Yes.

Q To the extent that marketwide services already provided, is it Dean Foods' position that all handlers providing qualified service of market benefit should be entitled to receive payment, if marketwide service payments are adopted?

A That is true.

Q There has been a lot of discussion about the Southeast proceeding in 1986. And one of the participants in that proceeding was a series of Carolina cooperatives from North and South Carolina. Correct?

A Yes.

Q Are you aware of whether the **major** cooperative in North and South Carolina has since become part of ~~the ---~~ **a different** entity?

A Yes, I think they merged with a cooperative in, in Maryland.

Q They are called ~~---~~ **Maryland -** Virginia **Milk** Producers ~~Market~~ **Cooperative**.

A Yes.

Q Which one of the proponents here?

A Yes.

Q And were you aware that the Carolina Co-op now part of the Maryland, Virginia, now a proponent in this proceeding, took the position in the Southeast proceeding that these kinds of payments should be made by those entities that receive them?

A Yes.

Q Dr. Ling testified concerning an issue of preserve and he mentioned the shrinkage and returns. Do you have a comment on that testimony?

A He suggested that that was part of the market reserve and I guess I take exception to that, because if a plant is operating, they have to bring into their plant every day that they are processing milk, enough milk to cover the shrinkage and to cover whatever -- returns there are back. That is just as important to take care of those, that they put in the bottle, themselves because it is part of it. So, it is not part of the reserve, it is part of the needed supply every day.

Q Now you have sat here through most of the hearing, correct?

A Yes.

Q Have you reached any conclusions about whether or not Order 1 as presently constructed and with marketing is being used to balance the milk from any other order?

A Well, there is a, and I think I alluded to that in my testimony here, there is milk moving out of this market in the fall months, and that milk is in here in the spring, and that certainly is, this market then is, that milk being in there in the spring is balancing the supply for another market.

Q And there are other examples, for instance, the milk from Minnesota, Wisconsin --

A Yes, that milk is in, there is a lot more of it in here anyway in the spring months than they are in the fall months, so the same thing can be said to that.

Q Now, regardless of that, I think you indicated in your statement that, there have been questions about this, and the implication that because the pool is benefitting from the Class I draw, when milk is transferred or diverted, that somehow that means that milk also will receive the marketwide service payment. Do you have any comment on that?

A Well, there are two parts to that. And let me, on the part where the producers are shipped and then it shows up as producer milk in the other market, there is no

Class I benefit on that. And I think that was the 80 million, the 80 million that I referred to in my testimony. That milk is back here in the spring and there is no Class I on that. Now, if there is bulk milk moving from a plant here and classified as Class I here to the other market, surely there is some benefit to this pool for the month or two that it moves. But, if that milk is back in here **for the remaining nine months** and this market is carrying a reserve, for that whatever benefit there was, is far offset by that.

Q And you could, you use in the very month that Dr. Ling says is the shortest, is the greatest distance between the fluid demand and the producer milk deliveries, does that not mean that it puts the greatest burden on unused capacity for that very time period?

A Well, surely it does. And I think the fact that it leaves that, it will be back as ~~surface~~ **surplus** milk in the spring months, too.

Q Requiring a greater capacity from the plants that are ~~---~~ **balancing.**

A There would be more of it.

Q Philosophically, your years of experience in federal orders, and understanding as ~~Dr. Ling~~ **Mr. Wellington** mentioned that principle purpose of the Federal orders is ~~--~~– **to bring forth an adequate** supply of fluid milk for the market. Do you have any comment on the provision in the order, Proposal 7, that would limit the diversions to 65 percent to a fluid milk plant?

A Well, the purpose as set forth in the preamble here, this proposal, is to provide milk to the fluid plants. And that provision is counterproductive to that. I can see. Because if you have to, have to establish that you are shipping 65 percent of your supply to manufacturing plant, **suppose** it is needed for a fluid plant. You are going to go ahead and ship it and forgot that just so we can qualify for the plant --

Q Just, it is 35 percent of the -- correct? It is 65 percent --

A Yes, yes.

Q But, that quarter means the same, it is just the number is different, correct?

A Yes, I am sorry.

Q But, nonetheless, your point is?

A My point is that it is counterproductive to require plants to put at least 35 percent into ~~--~~– **a manufacturing plant.**

Q I realize that you have prepared for other proposals and therefore, you weren't in the room. There was a colloquy between Mr. Arms and Mr. Tosi concerning the question of whether or not the Secretary should impose restrictions or examine the use of the money and as I heard the questions, I apologize if I misstate them, but as I understood them the questions from Mr. Tosi were asking Mr. Arms whether or not the Secretary had authority or in other areas examined the treatment by cooperative of payments they receive from milk. Assuming that was the discussion, do you have any comment on that issue and whether or not in this instance, should marketwide service payments **be adopted**, the Secretary has authority or needs to or with respect to the 35 restrictions on the use of the money?

A Well, I am aware of that. Under the terms of the Act, the cooperatives are free to distribute the money that they get in the form of ~~that~~ **the blend** price, from the order in any fashion and the Secretary doesn't interfere. In fashion consistent with their contacts with their members, that is what it is. And the Secretary doesn't get involved in that. However, it seems to me this is a little different. The other portion is just their share of the money created by the order. In this instance, the proposal would give them an additional share and that money comes out of the pockets of the non members, so I think there is a benefit requirement there,

there should be a requirement there that may account for that money and the fashion in which they, the payments are ~~forwarded~~ **for**.

MR. ENGLISH: Thank you, Mr. Conover. The witness is available for cross examination.

JUDGE BAKER: Thank you. Are there any questions for Mr. Conover? Mr. Beshore?

MR. BESHORE: Thank you.

CROSS EXAMINATION

BY MR. BESHORE:

Q Good evening, Carl. Has Dean Foods ever seen a marketwide service payment that it would support?

A I doubt it.

Q Maybe I had better stop right there.

~~What~~ **Where** is the 80 million you talk about in your testimony?

A I looked at the market statistics that were introduced in this record here and they show that in the southern market of five, six and seven --

Q Five and seven, we don't have six.

A Okay, five and seven. There is producer milk on that market from New York, Pennsylvania and Maryland in the fall months and it is not there in the spring months. And that is where the 80 million comes from. And that was August 2001.

Q In August 2001, you are saying the, some of the, some of the exhibits that were put in here, show producers in Maryland.

A Producers located in Maryland show up as producers on those markets.

Q Okay. And --

A New York and Pennsylvania.

Q New and Pennsylvania. In what ~~part~~ **volume**, the ~~bottom~~ **volume** of 80 billion pounds?

A It was plus 80.

Q And is that the only one you looked at?

A That is the only one I looked at. I have a feeling it would be equal to that in September.

Q Okay. And that was pooled on Order 5? It is milk that is pooled on those orders, correct?

A Yes, it was shipped as producer milk on those markets.

Q Which and it was marketed on Order 5 and Order 7?

A Yes.

Q Okay. And you didn't compare that number to any other months?

A No, I didn't.

Q Well, if there is any milk in, if there is milk in Maryland that is pooled year round by Order 5, which I feel to a certainty there is, what is the, what is the question, what is the problem?

A If, if the amount were the same, then you would have to discount that.

Q But, you only looked at one month.

A I only looked at one month.

Q So, then you don't know what the amounts are in any other months.

A No, they are not, it is not that great in the month of May, that I know. I did look at May.

Q Okay. So you looked at two months.

A Yes.

Q May of what year?

A The same.

Q You compared May and August of 2001.

A Yes.

Q And the difference May and August was what?

A I really didn't, didn't get that difference. It just looked like there was a great number of producers there in August and they weren't there in May. And the amount was there in August was in May.

Q But, you don't know how much was there in May.

A No.

Q Or June or January, right?

A I didn't look at those.

Q Okay. Let's, by the way you are aware that to the extent **that under** the proposal presented by Mr. Wellington, if that milk came back on Order 1, it would not be entitled to marketwide service payments until it was on the order for at least **three** consecutive months.

A I understand that is in your proposal.

Q So, I mean, whatever, possible issue there is, it is eliminated certainly, at least to the extent?

A To that extent.

Q Since we didn't compare, you only compared one month or two, you don't know how much it is, is on or off what periods of times, actually, isn't that fair?

A Well, the figures will speak for themselves. They are there in the record.

Q Well, what, what figures?

A Whatever ~~they said it~~ **the figures** shows.

Q For the months, the particular months that were put in by Mr. English?

A Yes.

Q Do you have any problem, there has been, there has been an issue made about milk sales by regulated Order 1 distributing plants that end up being distributed outside of the Order 1 marketing area, do you have a problem, since we don't have your written, a written statement from you, I am not sure I know exactly what your testimony was, is that a problem in your view?

A If it is milk that is received at a ~~food~~ **pool** plant --

Q Packaged at a plant.

A And then sold, then the market should carry the balance for that. That is my position on that. That ~~they~~ **is a** need in this market, this market being the aggregate of the ~~food~~ **pool** plants.

Q Okay. Do you have Order 5, I am sorry, Exhibit 5 available to you?

A I do not have it here.

(Pause.)

THE WITNESS: Now I have it.

BY MR. BESHORE:

Q Okay. If you look on page 82 of Exhibit 5.

A Eighty-two.

(Pause.)

BY MR. BESHORE:

Q Do you have that?

A I have page 82.

Q Now, the third column, the second and third columns on, on page 82, represents Class I sales by Northeast Order handlers and other federal order markets and non federal order markets, which I take to be unfederally unregulated areas in Pennsylvania, Virginia and New York, and perhaps Maine that are ~~continuous~~ **contiguous** to this order. Is that how you would interpret that?

A Couldn't it also include bulk shipments?

Q Class I sales by Northeast Order handlers. Perhaps, I don't know.

A It might include some bulk shipments to another market. So, it is, so it might be going to Florida or somewhere else, but insofar as it includes package, I agree with what you say.

Q Okay. You don't have any problem with those sales being --

A No, ~~I don't~~ **the packaged ones I don't**.

Q Package sales.

A The bulk is a different matter.

Q The bulk is different for what reason, because it may only be seasonal?

A Be seasonal and the surplus will be here in the spring.

Q Class I is here in the fall, and the surplus is here in the spring.

A And the rest of the months, really, not just the spring, but the, in the fall, three months, and then expect that, that volume plus the seasonal difference to be on this market for the remaining eight, nine months, whatever it is.

Q Okay.

A But, that is just the bulk. I --

Q Just the bulk, okay.

Now, the total, total Class I sales or Class I utilization by Order 1 pool distributing plants, volumes such as are reflected on page 82, it does not include the volumes that are the shrinkage and the returns in those handlers' operations, isn't that correct?

A No, it does not.

Q So, when Dr. Ling, if he was basing his Class I needs, as he testified, off of just the Class I utilization figures such as shown on page 82, it didn't include the shrinkage, correct?

A He understated just a little bit, the needs.

Q Okay. If he understated the needs, then it is legitimate to include that, that part of the need in the reserve, isn't it? I mean, basically that is what he is said, he ~~did~~ **didn't** include it in the Class I, somebody said you have to got to add it into the reserve.

A I think, to me the reserve is what you need other than what you are taking to service your plant.

Q Well, the reserve is what you need other than what you need to service the plant, but, if so, the service to the plant is not just the plant's Class I utilization, it is the plant's total demands, correct?

A Yes. Yes, that is what I was saying.

Q Whether it be Class II or whatever, Class IV shrinkage. Distributing plants --

A Yes.

Q The distributing plants total needs ~~or~~ **are** the demand that needs to be met and balanced by the reserves, correct?

A Yes. I --

(Pause.)

BY MR. BESHORE:

Q By the way, the Order 5, if you ~~are about~~ **have got** figures from pounds pooled from the State of, any of the states in this marketing area, shows the same amounts, show several amounts pooled, from month to month. It is not really an issue that you have indicated, right?

A It shows the same, it is not.

Q Did you look at the figures for 2002 provided by the Market Administrator?

A No.

Q ~~Is~~ **If** milk pooled on Order 5 from Pennsylvania and that in June 2002 was the same as was pooled in August

2001, there is not really a problem there, is it?

MR. ENGLISH: You are comparing 2001 and 2002, or are you comparing 2001?

BY MR. BESHORE:

Q August ‘01, ~~to~~ June ~~of~~ ‘02.

A That would be a legitimate ~~--~~- **comparison.**

Q With respect to that issue, does Dean Foods support the safeguard proposed by ADCNE through Mr. Wellington on the three month disqualification period, for milk that moves back on Order 1 before it can receive payments?

A Dean Foods, if there is going to be a marketwide service payment, that would be an appropriate position. That doesn’t mean that ~~this --~~- **it's for the** proposal.

Q Going back to the reserves, necessary reserves. You had some testimony about 70/30, right?

A Yes.

Q I am not sure how you got that. Have you done some calculations to indicate that you need about 30 percent more milk on a year round basis than the, than the Class I shipments in order to balance them?

A Yes, I have done some calculations that and over the years, but that was the nitty and gritty on that, and I think I am being liberal. I think you can balance with a little less than that. And I think in Dr. Ling's testimony, he had the necessary reserve ~~in~~ ~~020~~ **at 20**, didn't he? I think it was 20. He was 80/20 or higher than that even.

Q But, in your judgement and in your experience, 70/30 is about right.

A That is what I said, and I will stand by that. There are instances where you get by with less than that.

Q But, to be safe, it is --

A Yes.

Q Okay.

A Now, that necessary reserve that Dr. Ling pointed out, so I am going to agree with his concept there. There are two kinds of reserves. There are necessary reserve and then there is an excess reserve. I think marketwide service payments should be collected on balancing the necessary reserves.

Q And that is how --

A Because that is what, that is what the statute seems to imply.

Q Okay. And that is how --

A Not the excess reserve.

Q But, that is what Dr. Ling calculated. Whether you agree with his particular, you know, the, setting aside the, you know, the figures, the terms of cost figures, or whatever, he calculated, attempted to calculate, isolate, calculate, the cost of carrying the necessary reserve, correct?

A I am not, I am not sure of that. The way I read this proposal, payments would be applied to all of the milk out there, whether it was necessary or excess.

Q Well, if the cost of carrying the necessary reserve was spread over a smaller volume of milk in order to recover, the rate would be higher. That is just ~~a written thing~~ **arithmetic**, correct?

A Well, yes.

Q Okay. And as Mr. Wellington has testified, in order to recover the costs as isolated and calculated by Dr. Ling, the rate of six cents doesn't cover them all and they need to be applied to a ~~largest~~ **larger** universal cost, correct? That is what he calculated, that is ~~what his -- was~~ **the way the arithmetic works.**

(Pause.)

BY MR. BESHORE:

Q With respect to the 65 percent, your comments about the 65 percent qualification standard. If you have got a situation as we do in this market, which I think you have heard testimony about, when you have got a large volume of non member milk that is dedicated to this ~~, by~~

distributing plant supplies, on a year round basis.

A Yes.

Q You understand that. Now, the rest of the milk that is going to provide the balancing supply, the necessary reserves of that fluid market, is going to start with a ratio of deliveries that is going to be reduced because of the dedicated supply from the distributing plant, it is going to have a higher ratio of deliveries to non distributing plants because it is, you know, **because** a substantial portion of the distributing plants are met year round by the committed non member supply, is that right?

A I understand what you are saying, yes.

Q Okay. And the 70/30 is a good ratio for the total and the non members skim, skim, while the figures show, assume 70 percent of the Class I amounts, the figures show the non members are dedicated and supply 35 ~~,~~ **to** 40 percent of that year round. Now, you have got, for the balancing requirement, you have got about 30/30, don’t you?

A Yes.

Q Now, 65, 65 isn’t too bad in that equation, is it?

A I have no problem with the concept that the, the entity doing the balancing put 35 percent into manufacturing. That I have no problem. What I have a problem with is establishing that as the criteria for payments. Because then they are going to meet that without serving the plants when they are needed. That is what I was saying.

Q Well, payments should not go to the non members supplies that are delivered to the distributing plants year round, should they?

A Whoever, if the purpose of this is balancing the supply, it should go to those that are doing the balancing and have a record of balancing ~~of~~ that. The problem I have with that language is that it seems to say, here is an entity that is in a form and size, and it is handling enough milk to balance the market. It is going to put 35 percent into the manufacturing, and therefore, we get the payment because we could do it. There ought to be some element there as a criteria that they are doing it.

Q Okay. Well, they are doing it because the milk is meeting the qualification requirements of, to be pooled, isn't that correct?

A Well, it is pooled is meeting the qualification, yes.

Q And in addition --

A That is not quite the same as balancing, I don’t believe.

Q Well, pooling requirements has seasonal demands to them.

A That is solely the non member, or the proprietary plants meeting the pooling requirements.

Q The plants are meeting that, by their distribution of the products.

A Well, whatever their ~~markets~~ **requirements** are, they are meeting them, so, that meeting the pooling requirements shouldn’t be the qualification for getting payments.

Q How about being required to supply any additional supplies required for the fluid market as the language in Proposal 7, as determined by the Market Administrator, it is the language of Proposal 7 revised?

A Well, I, I think that, in order to qualify for payments there should be a record there that they are balancing the market. That is the point I am trying to make.

Q There is no question in your mind, is there, that the documented deliveries shown in Exhibit 17, that Dennis Schad presented of daily deliveries in May and November, the fluctuations, the variations, there is no question in your mind that that shows that the cooperatives represented in those deliveries are balancing in this market?

A I am not, I am not saying the cooperatives aren't balancing ~~the amount~~ **them now**, I am just saying I am bothered with the fact that you set up a criterion, and say, if we are structured in a fashion to do this, that qualified us for a payment. It doesn't make any difference whether we do it or not. I am troubled with that.

Q And that is the way you read the proposal?

A That is the way I read it.

(Pause.)

MR. BESHORE: I don't have any other questions for Mr. Conover. Thank you.

JUDGE BAKER: Thank you, Mr. Beshore.

Are there other questions for Mr. Conover? Yes, Mr. Tosi?

CROSS EXAMINATION

BY MR. TOSI:

Q Thank you for appearing today, Mr. Conover.

A My pleasure.

Q Do you think it is good policy, the Federal Order Program, that, excuse me, can you hear me?

Do you think it is a good policy, the Federal Order Program, that handlers charge producers for its service of balancing.

A Without, I think Congress decided that.

Q Well, I understand that Congress decided that, gives **them** the authority to the Secretary to decide what --

A To take it out of the funds, yes.

Q ~~Right.~~ Do you think it is good policy to do that? Do you think it would be good policy to do that given the conditions as you understand them here for the Northeast milk marketing area?

A I think it is not good policy unless there is an element of accountability made, so that people getting that money have to account for it and prove that it is being used to ~~fulfil~~ **fulfill** the purpose of this proposal.

Q And to the extent that you have heard testimony by other people that have appeared so far on behalf of the New York State Dairy Foods, to the extent that their testimony suggested that balancing payments, they were already paying that to cooperatives in their contracts for services or whatever term that we want to use, something above the ~~minimal~~ **minimum** order price, are you of the opinion that that would, that either directly or indirectly includes factors for balancing the market?

A No doubt in my mind with what, all of the over order pricing that I have been associated with, that was an element into ~~this thing that is~~ **payments** for balancing.

Q Given the conditions here for the, for the Northeast, to the extent that some entities' costs may be greater or less than others, should the Secretary exclude the costs of balancing to smaller individual that given the criteria right now, would not meet the --

A Anybody that can prove they are doing balancing, should be paid, if payments are going to be at all.

Q And what, why do you take that position?

A The purpose of it is to do the balancing and promote pay out of the fund for balancing, pay whoever is doing it, large or small. I don't --

Q In that regard, we are talking about equity.

A Yes.

Q Amongst handlers.

A Well, equity, it probably goes, there is a concept in uniformity, always in my mind under federal orders. I think you, the Act is strong on that, **you must treat** everyone ~~be~~ uniform. Not only equity, but the command that there is uniformity there as well.

MR. TOSI: Thank you very much. That is all I have.

JUDGE BAKER: Thank you, Mr. Tosi.

Are there other questions for Mr. Conover? Hearing none, thank you very much, Mr. Conover.

THE WITNESS: Thank you.

JUDGE BAKER: It is nice seeing you again.

(Whereupon, the witness was excused.)

JUDGE BAKER: Your Honor, I am complete with this, I think Mr. Fredericks, if he can get on ~~---~~ **,if he wants to tonight.**

JUDGE BAKER: Very well. Have you presented all of your witnesses?

MR. ENGLISH: On Proposal 7.

JUDGE BAKER: You have, all right.

MR. ENGLISH: There is a few other proposals in the hearing record.

JUDGE BAKER: Yes, I am aware of that.

Let me ask this. Is there anyone in the audience who would like to give testimony with respect to Proposal Number 7? For, against or otherwise? Let the record reflect that there is no response.

Mr. Fredericks, I will swear you in, sir.

Whereupon,

PETER FREDERICKS

having been first duly sworn, was called as witness herein and was examined and testified as follows:

DIRECT EXAMINATION

BY MR. STEVENS:

Q Welcome back, Mr. Fredericks.

A Thank you.

Q Earlier at the hearing, you were asked to, some questions and I think you have some material that you would like to enter into the record. Have you brought anything with you to, to indicate the answers to the questions that were asked earlier?

A Yes, I have.

Q What is the first one you want to put into the record?

A The first one is, a request to provide some additional information regarding page 86, table entitled “Producers Deliveries to Pool Distributing Plants, for January 2001 to June 2002.”

The second column on that table, the column to the right, which is entitled “Percentage of the **Proprietary** Handler Producer Milk Receipts Delivered to Distributing Plants.” And there is a double asterisk footnote on that, and I was asked by, by the Association of Dairy ~~,~~ **Cooperatives** Northeast Group, to see if I could recalculate the figures there, taking out any receipts from cooperative members producers that were included in that proprietary handler producer, pool producer. So, if you look at the double asterisk footnote there, and you remove the second sentence, starting "total proprietary -- " you see the second sentence, that is what I have done. So, now the figures here just include proprietary handler producer milk. And I can give you the monthly figures or I can give you the annual average. I am not certain which Mr. Beshore has referenced. But, I will start with the annual average. The year 2001, the way you see it now in your table, the annual average was 80.8 percent. You take out the figures I mentioned, that drops down two percentage points to 78.8 percent.

The second, 2002, the six month average, the current 78.1 percent, taking out that volume of many cooperatives that are pooled by proprietary handlers, would bring you down to 76.4 percent or a decrease **of** 1.7 percentage points.

Q Do you have the monthly figure there?

A Yes, I do.

Q Okay. Since you and your staff have gone to the work of generating those, why don't you go ahead and read them.

A Okay. For the month of January 2001, the new number would 83.3, February 80.6, March 81.5, April 79.6, May 78.8, June 77 percent even, July 80.4, August 75.7, September 79.2, October 77.2, November 76.9 and December

75.3. And for January 2002, 77.8, 76.7, March 77.2, April 75.5, May 75.9, June 75.9, I am sorry, 75.5 for June.

And the second, the second bit of information we were asked to provide had to do with the request on page 61, entitled “Total Additional Pounds of Partially Regulated Distributing Plant Milk Pooled under the terms of Proposal 9, for January 2002 through July 2002. In that table for those months in question, we, we indicated additional pounds that would have been pooled. We did not provide the names of the plants that would have been, been making up those pounds. And it was brought to our attention that it is more than the minimum of three handlers, but we were not going to reveal that information because you deduce from the change ~~--~~– **on a month to month** basis, some of the proprietary information from those plants. But, we did provide a listing of those plants that would be affected in any one month during that period of time. And I will --

Q Let me stop you there. I know you prepared a document. Would you like to read them into the record? Or would you like to enter it as an exhibit?

A Maybe it would be just as easy to enter it as an exhibit.

Q Okay. You have, I have some copies. You provide one for the judge and four for the reporter.

A Yes, I do.

(Pause.)

MR. STEVENS: Do you have some additional copies that would be available to the parties?

THE WITNESS: Yes, I do.

JUDGE BAKER: Mr. Fredericks' computation, a one page, it will be marked for identification as Exhibit 30.

(The document referred to was marked for identification as Exhibit 30.)

(Pause.)

MR. STEVENS: Exhibit 30, Your Honor?

JUDGE BAKER: Yes.

MR. STEVENS: Thank you.

JUDGE BAKER: You are welcome.

BY MR. STEVENS:

Q Okay. Now the document that has been marked for identification as Exhibit 30, and I might say with respect to your other information that you just gave for the record, that came from official records of the, of your office and the Department of Agriculture.

A That is correct.

Q And prepared by you or under your supervision in response to the questions?

A That is correct.

Q And again, it is not presented in favor or against any proposal, is it?

A No, it is not.

Q Thank you. This material on Exhibit 30, is additional material to supplement what was in Exhibit 5, right?

A That is correct.

Q And, and found on page 61 of Exhibit 5.

A That is correct.

Q The, the information referred to as Appendix 4-B.

A That is correct.

Q And, just again so the record will be clear, what is it putting in additional to what is already in, in Appendix 4-B?

A What is it providing is the names of the plants that would have become fully regulated under the terms of Proposal 9, not identifying any specific ones, but during that period of time, January 2002 through July 2002, they could have become regulated during that period of time.

Q Okay. And you have a footnote there also, don’t you?

A Yes.

Q How does that modify the information?

A That footnote just essentially says what I just, what I just paraphrased, plants listed reflect those that would have had a change in regulatory status at least one month during this time period.

MR. STEVENS: I offer the witness, and request and I would move the document into evidence.

JUDGE BAKER: Very well. Are there any questions of Mr. Fredericks? Yes, Mr. Vetne?

MR. VETNE: Just one, maybe two.

CROSS EXAMINATION

BY MR. VETNE:

Q Are the plants listed in the exhibit, primarily processing of milk into packaged food and milk products?

A That is correct.

MR. VETNE: That is all I have, thank you.

JUDGE BAKER: Very well. Are there any other questions of Mr. Fredericks?

Does anyone have any questions or objections to the admission into the record of what has been marked as Exhibit 30 for identification? Let the record reflect there is no response. Exhibit 30 is admitted and received into the record.

(The document referred to, having been previously marked as Exhibit 30 was received in evidence.)

JUDGE BAKER: Mr. English, is there anyone else that is going to testify this evening?

MR. ENGLISH: I don’t think it would make sense to try to start on Proposal 1. It is eight o’clock. I -- We have been going for 12 hours and intend start it in the morning on Proposal 1.

MR. VETNE: I concur. Maybe the only thing we agree on.

JUDGE BAKER: Very well. Tomorrow morning we will start on Proposal 1 and go through the proposals as they are listed in the Notice of Hearing and in the absence of --

MR. ROSENBAUM: Your Honor, this is Steve Rosenbaum, can I get confirmation that no one is going to take the stand tomorrow and say anything about Proposal number 7?

MR. BESHORE: We don’t plan any testimony at this time. But, if the hearing record is going to be open, and as long as it is open, I think any, you know, it could be open any proposal.

MR. STEVENS: This is Garrett Stevens, if a producer shows up and wants to testify, I am sure we are going to hear the testimony.

JUDGE BAKER: Mr. Rosenbaum, that is true. This is a public hearing and all parties who are interested and have testimony, which is relevant in the area, they do have the opportunity to testify. So, they wouldn't be precluded. But, colleagues have indicated that they will not call any witnesses.

MR. ROSENBAUM: Well, I don't quite go that far, Your Honor.

JUDGE BAKER: Oh, you didn't?

MR. ROSENBAUM: No. But, I don't presently have plans to do any rebuttal case with respect to Proposal 7.

JUDGE BAKER: Very well.

MR. ROSENBAUM: Although, I would not --

JUDGE BAKER: Very well.

MR. ENGLISH: Your Honor, one more comment, it may make sense for a couple of the witnesses, to testify about Proposals 1, 2, 3 and 4 all at one time, because they literally have maybe a paragraph on some of those proposals and it wouldn't make sense to take them off, put them on, take them off, put them on, if we can get them on, you know. All the rest of the proposals are, except, Proposal 1 is the reporting date, and then Proposals 2 through 6 and 8 through 13, are pooling issues. Proposal 14 is its a separate pooling issues. I can see these being grouped and I think it very well be the case when someone gets on, and testifies about Proposal 12, at the same time as Proposal 2. So, with that caveat, you know, we are certainly prepared to move along on Proposal 1 --

JUDGE BAKER: Very well. That makes sense. Do you have witnesses?

MR. ENGLISH: I have witnesses on the Proposals 1, 2, 3 and 4, and 14.

JUDGE BAKER: Very well. Mr. Vetne?

MR. VETNE: Yeah, I was going to say, I have some comments and concerns about how we schedule the presentation of the remaining proposals, but, you know, I would just as soon as address those in the morning. I don't think 1, 2 and 3 ought to come first, when as far as substantive involvement of the parties, and, and contested issues for pooling provisions are more important. Apparently, balancing was thought to be extremely important with a lot of opposition. It came first. Pooling is very important and has, and is contested and the another ones approximately not, you know, so, why should we take our time at the beginning with, with those --

MR. ENGLISH: Well, how about compromise, the important -- Well, there are two businessmen and two consultants on Proposals 1, 2 and 3, and we could get the businessmen on Proposals 1, 2 and 3. So, if we can at least get, get Mr. Fitchett, who testified today, done. I would -- that Mr. Arms and Mr. Conover, if you would prefer, to have Mr. Schad get on, and I think they should be able to, I, you know, I certainly would compromise.

JUDGE BAKER: Very well. We are in recess until tomorrow -- Thank you.

(Whereupon, at 8:00 p.m., the hearing was recessed, to reconvene at 8:00 a.m., on Friday, September 13, 2002.)