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UNITED STATES DEPARTMENT OF AGRICULTURE 11: 48  
Agricultural Marketing Service

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

(see <http://www.ces.uga.edu/Agriculture/agecon/workshops/dcon2005.htm> ), and was attended by a number of USDA Dairy Programs personnel and representatives for interested parties, including Dean Foods<sup>4</sup>, DFA, and others. These later events, if there were *ex parte* communications to or from interested parties, may also require supplementation of the record for the Mideast hearing, notice of which was issued on Feb. 11. The United States Court of Appeals for the District of Columbia Circuit recently acknowledged that while agency officials may need to meet with members of the regulated industry in order to properly perform their functions, an agency “wisely” places in the public record a copy or summary of *ex parte* communications even if there is just a “chance that the industry representatives were attempting subtly and indirectly to influence the outcome of [the] proceeding.” *Electric Power Supply Ass’n v. FERC*, 391 F.3d 1255, 12\_\_ (DC Cir., Dec 10, 2004), citing *Louisiana Ass’n of Independent Producers and Royalty Owners v. FERC*, 958 F.2d 1101, 1112 (D.C. Cir. 1992). This process helps preserve the integrity of, and public confidence in, the agency decision-making process, as intended by Congress in the 1976 “Government in the Sunshine Act,” P.L. No. 94-409.

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

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

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

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

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

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

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

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

April 6, 2005

Respectfully submitted,

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Attorney for Requestors

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

25 Part of the plan of DFA when our organizers

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

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

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

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

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

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

1       retired \$198 million of member equities that those  
2       farmers brought in the DFA and what we have earned for  
3       them since we started.

4               What are some of our challenges, what about  
5       tomorrow. You all know the Department of Justice is in  
6       a full investigation of us at DFA, and what we think  
7       they are trying to decide is whether or not we have  
8       lost our separate stead of unity by reason of things  
9       that we have done through force or intimidation or  
10      causing dairy farmers to become members of DFA that  
11      don't want to be members of DFA. And so they are now  
12      involved in a full scale investigation of DFA. And I  
13      guess you could say -- first off, we will cooperate  
14      with them 100 percent. And many of your cooperative  
15      friends around the country has probably received  
16      requests from the Justice Department for information in  
17      trying to get a feel from other cooperatives how they  
18      feel relative to DFA and whether we have strong-armed  
19      them, intimidated them, used coercion to cause them to  
20      do certain things. But you could say that we are being  
21      looked at because we are active. We have no qualms but  
22      when they get through they won't find any strong-arm  
23      tactics or any coercion or anybody being asked,  
24      required or demanded to do something they don't want to  
25      do. They are also asking some of our board members how

1 involved they are in the operation of the DFA. And  
2 somehow I think they believe there's 196 DFA area  
3 council board members that serve on our seven area  
4 council are not involved in the operation of DFA.  
5 That's what we think is involved. But we are involved  
6 and will vigorously defend ourselves against this full  
7 scale D of J investigation. And maybe it is because we  
8 just won one with them. We own 50 percent of a single  
9 plant joint venture with a fellow by the name of Bob  
10 Allen in Somerset, Kentucky. Bob Allen was the  
11 president of the board at one time and he and us bought  
12 a single plant. He manages. He's the partner that  
13 runs it. And you can see where Somerset, Kentucky is.  
14 About 30 miles down the road from Somerset, Kentucky,  
15 is a plant owned by National Dairy Holdings, called  
16 Flav-O-Rich in London, Kentucky. And in extreme  
17 eastern Kentucky -- excuse me, western Kentucky there  
18 are 40-something counties where only Southern Belle,  
19 which is the one in Somerset, and Flav-O-Rich are the  
20 only two bidders on school milk. And since DFA owns  
21 half of one and half of the other, Justice has brought  
22 a suit against us because of our interest in Southern  
23 Belle indicating that we were in a position to get  
24 sensitive information from both companies and to  
25 instruct them on how to bid for school milk so we could

1 maximize profit, take advantage of the school  
2 districts. We indicated we can't do it under our  
3 contract while managers. We don't do it since we do  
4 not have that access. We were deposed. Allen Meyer of  
5 MDH was deposed. So was Bob Allen. We asked the  
6 court, a Federal Court in Kentucky, for what lawyers  
7 call a summary judgment which means judge, look at the  
8 facts, look at the law, and let's not have a trial  
9 because there's no basis to have a trial. Normally you  
10 don't get judges to agree with you to not have a trial,  
11 not be heard, but in this case this judge said to the  
12 Department of Justice you don't have any basis to sue  
13 based on what we see, and they granted our summary  
14 judgment and threw Justice out of court. Now the  
15 question is will they appeal. They have 60 days from  
16 August 31st to make that decision and we don't know  
17 what they will do. And it could be that our success in  
18 this case has given them some added figures to look at  
19 on the other deal.

20           You heard a lot of about CWT. And it is  
21 great. And it will make a very significant  
22 contribution to your economic well being this year.  
23 But don't expect miracles. We are, as you heard,  
24 planning to take 49,000 cows out of the nation's dairy  
25 herd through the herd retirement feature of CWT and

1 we've set up the amount of money we allocated for that  
2 part of the program. But from May to August, according  
3 to USDA numbers, in all the states of the country, not  
4 just the 20 that they get regular monthly data on, they  
5 estimate we have increased the number of cows we are  
6 milking by 53,000 head. So when we take 49,000 out of  
7 the CWT we will merely be removing most of those that  
8 we have kept since May until now. And CWT's herd  
9 liquidation, herd retirement does not start, even  
10 though the bidding process is in place, the cows, the  
11 town will not start until December. So we have some  
12 time between now and the time those cows go to market  
13 while that milk is still flowing. So my question to  
14 you, I guess, is if we want to have a significant  
15 continuing market influx, to balance supply with  
16 demand, five cents a hundredweight may not be enough in  
17 the future to have the same impact that we had in the  
18 past of this year. We mentioned the producer handler  
19 issue, and there is a very large dairy in the west who  
20 now is packaging milk for Costco and Costco is taking  
21 reduced cost -- apparently reduced cost of milk to the  
22 marketplace and giving our customers all kinds of fits  
23 in the marketplace. And they've had to meet that lower  
24 price at retail and at wholesale and they've backed up  
25 to us, our customers have backed up to us, say you got

1 to keep us competitive. We are not competitive with  
2 these producer handlers. They are selling class one  
3 milk on the blend. We've got to have a reduction in  
4 our cost of milk. So that's the pressure we are  
5 feeling by reason of this, and the solution to it is  
6 obviously regulation of producer handlers the same as  
7 we have regulated handlers.

8 The industry challenge, the industry  
9 challenges, I might add, as you know are dairy  
10 promotion. The producer side of our dairy promotion  
11 plan is under review by the Supreme Court. The last  
12 court to review, the Court of Appeals declared the 15  
13 cents that you are contributing for promotion is  
14 illegal, an unfair restraint of free speech. There is  
15 some great hope I think in the promotion community that  
16 the Supreme Court will hear that and will rule that it  
17 is not a violation of free speech and continue the  
18 plan. If it is not, if it does not, it finds that the  
19 Court of Appeals will agree with that, we have some  
20 major restructuring to do in our promotion community if  
21 we want to continue the generic advertising and  
22 promotion plan. So that is one of the major challenges  
23 I see.

24 Fluid processors, they contribute 20 cents,  
25 you know, to the White Mountain Mustache Program.

1       Theirs is not being challenged, only yours. And our  
2       per capita consumption of class one continues to go  
3       down. And another challenge that we need to address is  
4       the round packages that we are putting out, the waivers  
5       we are putting in them, and the more avenues of  
6       distribution that we are gaining, such as McDonald's  
7       and Wendy's is the right place, the right time, putting  
8       those packages into schools is the right thing to do,  
9       but you can see we have a long history of reducing your  
10      class one market on a per capita basis. Today the  
11      largest single market for your milk in the United  
12      States is not class one. It is cheese. We produce --  
13      we make more cheese out of more milk which you produce  
14      than we do sell as class one. A challenge. Additional  
15      ones we've got to deal with is the animal  
16      identification and that hinges back into whether or not  
17      the Canadian border will be open. Our guess is that it  
18      won't be open until we have a reliable, universally  
19      applicable, individual animal identification plan in  
20      place so that we can trace from birth to death every  
21      animal, every piece of livestock that we have. We've  
22      got this whole issue we mentioned this morning of  
23      safety, of homeland security, and quality assurance and  
24      traceability where we can trace a pound of cheese all  
25      the way back through the system to your individual farm

1 to know what was in that piece of cheese, and that's  
2 going to be increasingly more difficult. And the  
3 biggest challenge I see we have at DFA is keeping Rick  
4 and Greg and Clyde challenged. Because they can eat up  
5 more work than anybody I have ever seen and we are  
6 extremely fortunate to have them working for us in  
7 addition to working for you. Thank you very much.

8 (Applause.)

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