

UNITED STATES DEPARTMENT OF AGRICULTURE

BEFORE THE SECRETARY OF AGRICULTURE

In re:) [AO]
) Docket No. 15-0071
))
Milk in California)
))

VOLUME XVIII

TRANSCRIPT OF PROCEEDINGS

October 19, 2015

Myra A. Pish, CSR No. 11613

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In re:) [AO]
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BEFORE U.S. ADMINISTRATIVE LAW JUDGE
JILL S. CLIFTON

Monday, October 19, 2015

9:03 a.m.

Clovis Veterans Memorial District
808 4th Street
Clovis, California 93613

TRANSCRIPT OF PROCEEDINGS

VOLUME XVIII

Reported by:
Myra A. Pish CSR
Certificate No. 11613

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CALIFORNIA PRODUCER HANDLERS ASSOCIATION: Stoel Rives
BY: NICOLE HANCOCK, ESQ
VICTOR LAI, ESQ.

SELECT MILK PRODUCERS: MILTNER LAW FIRM, INC.
BY: RYAN MILTNER, ESQ.
KRISTINE REED, ESQ.

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DR. WILLIAM SCHIEK:

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1 MONDAY, OCTOBER 19, 2015 - - MORNING SESSION

2 JUDGE CLIFTON: We are back on record on the 19th of
3 October, 2015. It's a Monday. It's approximately 9:03 in the
4 morning and this is Day 18 of the milk hearing.

5 We're in Clovis, California. My name is Jill Clifton.
6 I'm the United States Administrative Law Judge who is assigned
7 to take in the evidence of this hearing. I do not participate
8 in the decision, I merely certify the record. The record being
9 the record of exhibits and the record of the testimony. We
10 will invite any corrections to the transcript before I certify
11 that record. We'll also have a briefing schedule and everyone
12 is welcome to submit a brief. A brief is to comment on the
13 evidence and the law. To the extent you wish to focus on a
14 particular area, you are welcome to do that. The briefs are to
15 assist in analyzing and digesting the contents of the record.
16 All right. Briefs are not considered part of the record
17 because they are not evidence, but they are useful as argument.

18 I would like now to take appearances of other United
19 States Department of Agriculture employees. If you would come
20 to the podium, please, and not only identify yourself, but at
21 this juncture I would like you to again state what your job is,
22 as well as what you'd normally say as where you fit in the U.S.
23 Department of Agriculture.

24 MS. MAY: Good morning, Laurel May, L-A-U-R-E-L, M-A-Y,
25 with the U.S. Department of Agriculture, Agricultural Marketing

1 Service, Dairy Program, and my job is a Marketing Specialist
2 and all other duties as assigned.

3 MS. ELLIOTT: Good morning. Pamela Elliott, E-L-L-I-O-T-T,
4 I am a Marketing Specialist with the USDA, AMS Dairy Program.

5 MR. RICHMOND: Good morning, William Richmond,
6 R-I-C-H-M-O-N-D, also with the USDA, AMS Dairy Programs, and I
7 am also a Marketing Specialist.

8 MR. SCHAEFER: Henry Schaefer, H-E-N-R-Y, S-C-H-A-E-F-E-R,
9 Agricultural Economist for the Upper Midwest Milk Marketing
10 Order, Federal Order 30, and I'm on detail here for USDA Dairy
11 Programs.

12 MS. BECKER: Good morning, Lauren Becker, B-E-C-K-E-R, I'm
13 an attorney in the Office of the General Counsel.

14 MR. HILL: I am Brian Hill, B-R-I-A-N, H-I-L-L, an attorney
15 for the Office of the General Counsel.

16 JUDGE CLIFTON: And now we'll take appearances for
17 proponents and/or opponents.

18 MR. BESHORE: Good morning, Marvin Beshore, M-A-R-V-I-N,
19 B-E-S-H-O-R-E, Attorney representing the proponents of Proposal
20 1, a California Dairies, Inc., Dairy Farmers of America, Inc.,
21 and Land O'Lakes, Inc.

22 MR. HOLLON: Good morning, I'm Elvin Hollon, E-L-V-I-N,
23 H-O-L-L-O-N, and I'm employed by Dairy Farmers of America in
24 support of Proposal Number 1.

25 JUDGE CLIFTON: And what's your job with Dairy Farmers of

1 America?

2 MR. HOLLON: I deal with some day-to-day milk marketing
3 activities, some type of price forecasting. I deal with
4 movement of milk around our Cooperatives to our customers, and
5 the balancing of those milk supplies. And then I deal with
6 regulatory issues such as these types of hearings.

7 JUDGE CLIFTON: Thank you.

8 DR. ERBA: Good morning, Eric Erba, E-R-I-C, E-R-B-A, I'm
9 with California Dairies, Inc., and my job title is Senior Vice
10 President and Chief Strategy Officer.

11 MR. SCHAD: Good morning, Dennis Schad, S-C-H-A-D, I'm
12 Director of Middle-Atlantic Milk Sourcing and Regulatory
13 Affairs for Land O'Lakes.

14 MS. VULIN: Good morning, Ashley Vulin, A-S-H-L-E-Y,
15 V-U-L-I-N, I'm an attorney with Davis, Wright, Tremaine,
16 representing the Dairy Institute of California.

17 DR. SCHIEK: Good morning, William Schiek, that's
18 S-C-H-I-E-K, I'm Economist for Dairy Institute of California,
19 proponents of Proposal 2.

20 MR. BLAUFUSS: Good morning, Rob Blaufuss, B-L-A-U-F-U-S-S,
21 I'm with the Dean Foods Company.

22 JUDGE CLIFTON: And your job?

23 MR. BLAUFUSS: Senior Manager of Dairy Risk Management and
24 Economics.

25 JUDGE CLIFTON: Senior Manager of what?

1 MR. BLAUFUSS: Dairy Risk Management and Economics.

2 JUDGE CLIFTON: Dairy Risk Management and Economics. So
3 you know, when you testify, you are going to have to slow it
4 down.

5 MR. DeJONG: James DeJong, D-e-J-O-N-G, I am the Dairy
6 Policy and Economic Analyst for Hilmar Cheese, dairy-farmer
7 owned manufacturer of cheese, whey, and milk powder.

8 MR. DRYER: Good morning, I'm Greg Dryer, G-R-E-G,
9 D-R-Y-E-R, Senior Vice President, Industry and Government
10 Relations for Saputo Cheese USA.

11 MR. VETNE: John Vetne, V-E-T-N-E. I'm a representative
12 for Hilmar Cheese.

13 MR. ZOLIN: Good morning, Alan Zolin, A-L-A-N, Z-O-L-I-N, I
14 am a consultant here representing Hilmar Cheese, I advise them
15 on dairy policy and dairy supply chain issues.

16 MS. HANCOCK: Nicole Hancock with Stoel Rives,
17 H-A-N-C-O-C-K, S-T-O-E-L, R-I-V-E-S, and I represent the
18 California Producer Handlers Association and Ponderosa Dairy.

19 MR. LAI: Good morning, my name is Victor, last name is
20 L-A-I, I'm General Counsel with Producers Dairy Foods, a member
21 of the California Producers Handlers Association.

22 JUDGE CLIFTON: Now, well before I have others identify
23 themselves, I just want to mention that Chip English is
24 present. He had a 9:00 telephone conference in a case that had
25 some urgency and he could not avoid taking that call, but he's

1 in the building and when he comes back, I would like him to put
2 in his appearance.

3 And now I would like to take the appearances of others
4 who may not be part of a proponents team, but are
5 participating.

6 MS. REED: Good morning, Kristine Reed, K-R-I-S-T-I-N-E,
7 R-E-E-D, with the Miltner law firm, M-I-L-T-N-E-R representing
8 Select Milk Producers.

9 MR. MILTNER: Good morning, Ryan Miltner, also with Miltner
10 law firm, representing Select Milk.

11 MR. METZGER: Erick Metzger, E-R-I-C-K, M-E-T-Z-G-E-R,
12 General Manager of National All-Jersey, Incorporated.

13 JUDGE CLIFTON: National what?

14 MR. METZGER: All-Jersey.

15 JUDGE CLIFTON: National All-Jersey, Incorporated. Thank
16 you. Is there anyone who has not yet come forward who would
17 like to testify today? Not yet. We're welcoming anyone at any
18 time to drop in. If you are a dairy farmer, we would like to
19 schedule you at your convenience to the extent possible, and
20 we'll interrupt other witnesses to do that.

21 Now, I would like to take some announcements,
22 preliminary issues, and the like.

23 MS. MAY: Good morning, Laurel May with USDA. Welcome back
24 for our continuing hearing. It's good to see all of you this
25 morning. As you know, anyone that would like to is welcome to

1 testify in this hearing, as the Judge just mentioned. And if
2 anybody would like to question any of the witnesses, they may
3 do so by approaching the podium.

4 We are continuing to broadcast this hearing via live
5 audio feed. The link for the feed is at:
6 www.ams.usda.gov/live.

7 The court reporter is continuing to record official
8 transcripts for us, and those are hopefully available
9 approximately two weeks after the end of each hearing week, and
10 you can access those transcripts at our AMS Dairy website.

11 We also have a few copies of some past exhibits in the
12 back of the room on those tables if you would like to pick some
13 of those up.

14 We do have a few logistics to talk about this morning.
15 As you know, as we discussed last week, we will be moving this
16 hearing on Thursday and Friday of this week to the Piccadilly
17 Inn at the Airport, which is down on Clinton and McKinley. So
18 plan to be there at 9:00 on Thursday morning.

19 We also thought it would be appropriate to tell you
20 kind of where we stand as far as scheduling goes. At this
21 point we had hoped, and have made plans to have this hearing
22 last through November 6th, but just as a back up, we have
23 scheduled the Piccadilly Inn again for the following week, the
24 week of November, I guess it would be the 16th -- 9th. Right.
25 The 9th. And that week has a Federal holiday in the middle on

1 the 11th. We haven't actually scheduled that room at the
2 Piccadilly for the 11th, so we were interested in kind of
3 getting some feedback from you about whether, if we were here
4 that week, whether you would want to continue to push
5 through -- Mr. Vetne is nodding yes -- on Wednesday. Any other
6 nods or -- Ashley is yes; Marvin is yes, keep going. So like I
7 said, we don't exactly have the room yet, but we'll see if we
8 can get it and we'll let you know how that goes.

9 We were unable to find anything local for the following
10 week, the week of November 16th. So if we're not done by the
11 end of the week of the 9th, our next best back up is two weeks
12 in December for which we were able to get this building again,
13 December 7th week, and December 14th week. So just sort of for
14 planning purposes you can see what we have been able to
15 schedule. Is there anything else I need to say about that?

16 JUDGE CLIFTON: No, that's excellent. May I have a show of
17 hands of those of you who think we might finish by November
18 6th? That was just a might I got -- okay. Thank you,
19 Mr. Vetne.

20 MR. HOLLON: Would you read the December dates again?

21 MS. MAY: If we needed to, we have reserved this building
22 for the week of December 7th and the week of December 14th. It
23 would require a little bit of shuffling around that first week,
24 but we would be here.

25 Okay. So at the end of Friday, I believe Mr. Hollon

1 was finished with his cross-examination on his third set of
2 testimony. And I believe that we're going to start with
3 Mr. Hollon again this morning on his next set.

4 JUDGE CLIFTON: Thank you, Ms. May. I would like to say,
5 again, how much I have appreciated the quality of everything
6 about this hearing. The presentations have been outstanding,
7 and the logistics what the Agricultural Marketing Service
8 arranged for us is has been splendid. I'm just delighted and I
9 thank you.

10 Other preliminary issues or scheduling issues? I see
11 no one wanting to do that now, so we will resume the testimony
12 of Mr. Hollon on a new topic.

13 We're distributing the exhibit. Let's see, the number
14 of this exhibit, Ms. Elliott, do you have that right at your
15 finger tips?

16 MS. ELLIOTT: Yes, ma'am.

17 MR. BESHORE: We actually have, if I might, sorry to
18 interrupt, but there are four separate documents for this, or
19 exhibits, for this fourth and final appearance of Mr. Hollon.

20 The first one is Exhibit 20A which has already been
21 given a place holder as Exhibit 20A, which is the couple of
22 pages of corrections to Exhibit 20, where there were some mis
23 downloaded or some erroneous numbers on a couple of the columns
24 of one. So that's 20A.

25 JUDGE CLIFTON: Okay. Stop there for just a minute. If we

1 look at 20A, we still also need to look at 20 for other things
2 that are not in 20A?

3 MR. BESHORE: Yes.

4 JUDGE CLIFTON: Okay.

5 MR. BESHORE: 20A has a cover page, which identifies the
6 four pages behind it. And there are four pages of Exhibit 20
7 which required correction. The corrected areas are highlighted
8 in yellow on the pages, they are 1.B.4, 1.B.5, 1.C.4, 1.C.5,
9 but yes, they need to be read with the rest of 20.

10 JUDGE CLIFTON: Excellent. This is very professionally
11 done. I like this. Thank you.

12 All right. So that one will not need another exhibit
13 number, but we should note that we are now talking about 20A.
14 I mean, it will need that number, but it won't need another
15 number in the sequence.

16 (Thereafter, Exhibit 20A was marked
17 for identification.)

18 MR. BESHORE: Okay. We then have three other separate
19 exhibits. The testimony of Elvin Hollon, Fourth Statement,
20 which is cover plus twelve pages, I would ask be marked as the
21 next consecutive number.

22 JUDGE CLIFTON: And Ms. Elliott, will that be 75?

23 MS. ELLIOTT: That's correct.

24 JUDGE CLIFTON: That will be 75.

25 (Thereafter, Exhibit 75 was marked

1 for identification.)

2 MR. BESHORE: Thank you. Then exhibit of Elvin Hollon
3 (Fourth Statement), which is cover plus five pages. I would
4 ask we mark this as Exhibit 76, that has table 8.1.

5 (Thereafter, Exhibit 76 was marked
6 for identification.)

7 MR. BESHORE: And finally, a short well, a four-page
8 document, title, Proposal 1 Provision for Payments by a Handler
9 Operating a Partially Regulated Distributing Plant, which
10 relates to part 76 of Proposal 1, in uniform part 1000.76. I
11 ask that that be marked as Exhibit 77.

12 JUDGE CLIFTON: And it shall be so.

13 (Thereafter, Exhibit 77 was marked
14 for identification.)

15 JUDGE CLIFTON: So 75 is the testimony, and at the bottom
16 of that page is already typed Cooperatives' Exhibit 8, that
17 will be -- that is 75. And 76 is Table 8.1; and 77 is Proposal
18 1 Provision for Payments.

19 Mr. Hollon, you remain sworn. Would you again state
20 and spell your name?

21 MS. HANCOCK: Your Honor, Ms. Hancock. Your Honor, we're
22 still getting them.

23 MR. BESHORE: We're still distributing some of the
24 exhibits, your Honor.

25 JUDGE CLIFTON: Very good. We'll hold off a moment. About

1 how many did you receive, Ms. Elliott?

2 MS. ELLIOTT: I only received 75 and 76.

3 JUDGE CLIFTON: And they weren't clipped to the others?

4 MS. ELLIOTT: No.

5 JUDGE CLIFTON: It doesn't seem right not to have
6 Clifford Carman there. Are you going to save him a set? I
7 would imagine he would want the paper. Let's put a set in his
8 place. If they don't need it, they will do something else with
9 it. Sometimes it's good to look at paper even though you have
10 got an electronic version. We'll just accumulate for Clifford
11 Carman in that empty chair. All right.

12 Now, just to be sure, Ms. Elliott, now that you have
13 them, I want to make sure you are marking them the same as I
14 am. So the one that is 75 has near the bottom Cooperatives'
15 Exhibit 8 on it.

16 MS. ELLIOTT: Yes.

17 JUDGE CLIFTON: And the one that is 76 has just one
18 exhibit, Table 8.1. And the one that is Exhibit 77 says at the
19 top, Proposal 1 Provision for Payments, I'm not reading the
20 entire title, just that much.

21 MS. ELLIOTT: Yes.

22 JUDGE CLIFTON: All right. Good. Thank you.

23 Mr. Hollon, you may state and spell your name.

24 MR. HOLLON: Elvin, E-L-V-I-N, Hollon, H-O-L-L-O-N.

25 JUDGE CLIFTON: Mr. Beshore, you may proceed.

1 MR. BESHORE: Thank you, your Honor.

2 DIRECT EXAMINATION

3 BY MR. BESHORE:

4 Q. Let's turn to Exhibit 20A first, Mr. Hollon.

5 A. I have it.

6 Q. Okay. Could you just walk us through this exhibit,
7 which provides some corrected pages for a couple of the tables
8 in Exhibit 20; is that correct?

9 A. That is correct. There are four pages in each case.
10 There is a set of corrected numbers, and then that's one page;
11 and then the following page is where those corrected numbers
12 would have impacted a summary average or statistic. So the
13 first page is Table 1.B.4. And on that table there were prices
14 for the Class I Southern California announced price by CDFA for
15 11 months in February, one month in January that were incorrect
16 on the original submission and now have been changed.

17 Q. Just to be clear, 11 months in 2012, beginning with
18 February?

19 A. Correct.

20 Q. And one month in 2013?

21 A. Correct.

22 Q. Okay. That's Column H?

23 A. Column H. And that would have affected the
24 subtractions in Columns I and J. Column K also contained data
25 that was erroneous, that's been replaced, and that would affect

1 the subtractions in Columns L, M, and N.

2 Turning to Table 1.B.5 --

3 Q. So just to be clear, on Table 1.B.4, the rest of the
4 numbers that are not in the yellow highlighting, highlighted
5 area 1.B.4 are the same as on Original Exhibit 20?

6 A. Correct.

7 Q. Okay. Go on to the next page then.

8 A. Table 1.B.5 contains changes where those numbers would
9 have impacted an average or a median calculation, and those are
10 in columns H, I, J, K, L, M, and N, and they would only impact
11 numbers that had 2012, and one month in 2013 data.

12 Q. Okay. And again, the numbers on this Exhibit 1.B.5
13 which are not highlighted, are the same as on Exhibit 20?

14 A. Correct.

15 Q. Thank you. Okay.

16 A. Table 1.C.4 is the next page where there are
17 corrections, and these tables were used to compare, to show
18 price comparisons for out-of-market handlers with in-market
19 handlers, and the same numbers would be corrected. So in Table
20 1.C.4, Column T would pull over the prices that were corrected
21 earlier. Column U, the subtraction calculation; Column C would
22 pull over the prices corrected earlier; column that's labeled Z
23 minus Y would be the correction for the subtractions; column AF
24 would pull over the prices corrected; and column AG, the
25 correction for the subtractions.

1 Table 1.C.5 displays where there might be some average
2 or median calculation that would have been impacted by those
3 changes.

4 Q. And again, on 1.C.4 and 1.C.5, only numbers in the
5 yellow highlighted area have changed from Exhibit 20, correct?

6 A. Correct.

7 Q. Okay. Thank you.

8 Now, your testimony, Exhibit 19, describes some of the
9 data in Exhibit 20, and are there a couple of numbers that you
10 stated in Exhibit 19 which change with the changes in
11 Exhibit 20A?

12 A. That would be correct.

13 Q. And I would note, your Honor, Mr. Hollon is just going
14 to verify the numbers that changed. We're just going to note
15 those and where they are, we haven't provided substitute pages.
16 It's just small changes in a couple of numbers, and we note
17 down and they will be in the record.

18 JUDGE CLIFTON: All right. So do people need to get their
19 20 out to do it, or is it better if we just take notes?

20 MR. BESHORE: Either way. I mean, I think you can take
21 notes and go, but if you have 19, it would be, if you have 19
22 and you want to refer to it, you could make your notes right on
23 it.

24 JUDGE CLIFTON: And do you want, let's see, the record copy
25 is probably already gone. We won't -- so we won't try to

1 change it on the record copy.

2 MR. BESHORE: No, I wasn't, I propose that we not change
3 the them they are pretty minor.

4 JUDGE CLIFTON: All right. Good. Then for my purpose, I'm
5 just going to take good notes right now.

6 MR. BESHORE: So do you have those to be noted, Mr. Hollon?

7 MR. HOLLON: I do.

8 MR. BESHORE: Okay.

9 MR. HOLLON: On page 14, the second line up from the
10 bottom, currently reads, "August 2012 through July 2015, the
11 short fall is 37 and 27 cents per hundredweight." In that
12 sentence, the 37 should be changed to 36, and the 27 should be
13 changed to 26.

14 And all of the other changes are on page 15. So the
15 first full sentence on the top of page 15, currently reads:

16 And for the months since then, the Northern California
17 price has been below the FMMO grid each year, by a low of 2
18 cents per hundredweight (\$1.60 zone) to \$0.33 in the \$1.80
19 zone. In that sentence, the 2 cents should be changed to 3
20 cents, and the 33 cents shows no change.

21 In the second full paragraph, the second to last
22 sentence, currently reads:

23 "When comparing the annual CSO Southern California
24 price with the announced FMMO price at Phoenix, the difference
25 averages minus 61 cents."

1 MR. BESHORE: Currently reads.

2 MR. HOLLON: I'm sorry, minus 62 cents, and that should be
3 changed to minus 61 cents.

4 BY MR. BESHORE:

5 Q. Okay.

6 A. In the third full paragraph, the second to the last
7 sentence currently reads:

8 "However, comparing the Southern California announced
9 price with the Las Vegas price results in a difference of minus
10 27 per hundredweight average for the August 2012 to July of
11 2015 period."

12 In that sentence, minus 26 cents should be changed to
13 read -- I'm sorry -- minus 27 cents should be changed to read
14 minus 26 cents.

15 Q. Those are the only impacts in the Exhibit 19 which are
16 the changes in Exhibit --

17 A. Yes.

18 Q. All right. Okay. Thank you.

19 JUDGE CLIFTON: Your voice trailed off. So what you said,
20 Mr. Beshore, was impact from 20A?

21 MR. BESHORE: Yes.

22 JUDGE CLIFTON: Okay.

23 MR. BESHORE: Thank you.

24 BY MR. BESHORE:

25 Q. Let's turn then, Mr. Hollon, to Exhibit 75, your fourth

1 statement of testimony, and it concerns the proposal regarding
2 producer-handlers.

3 JUDGE CLIFTON: And, Mr. Beshore, you are going to have to
4 work hard not to let your voice trail off because you did it
5 just then, and the only way I know you said producer-handlers
6 is it says that on the exhibit.

7 MR. BESHORE: I'll work on that.

8 JUDGE CLIFTON: Thank you.

9 BY MR. HOLLON:

10 COOPERATIVES' PROPOSAL 1 REGARDING PRODUCER-HANDLERS

11 The Cooperatives propose that producer-handlers ("PH")
12 be regulated in the same manner as in the proposed California
13 Federal Milk Marketing Order (FMMO) as they are in other
14 orders, for example, 7 CFR Section 1030.10 (Producer-handler
15 definition in Order 30.) As we understand their operations,
16 all of the members of the California Producer Handlers
17 Association would become fully-regulated handlers under our
18 proposal. We consider the question of the treatment of exempt
19 quota to be a separate issue and will discuss it separately.

20 My testimony opens with significant points from the
21 final decision from the 2009, ten-order -- that's a correction
22 in the written testimony -- eleven should be ten.

23 BY MR. BESHORE:

24 Q. Yeah, your editor can't count right.

25 A. Starting that sentence over again.

1 My testimony opens with significant points from the
2 final decision from the 2009, ten-order producer-handler
3 hearing, which sets the stage for our proposal regarding large
4 producer-handlers.

5 Q. Or regulating?

6 A. Regulating large producer-handlers.

7 JUDGE CLIFTON: I'm sorry, go back if you will. I don't
8 understand the reference to 2009, ten-order hearing. Meaning
9 it affected ten Federal Orders?

10 MR. HOLLON: Yes, ma'am.

11 JUDGE CLIFTON: Okay. Thank you.

12 MR. HOLLON: Next is a summary of those points and the
13 measure of the impact not regulating large producer-handlers.
14 Finally, we present the language of our proposal regarding
15 producer-handlers.

16 A. The 2009 national hearing on producer handlers

17 The 2009 -- substitute ten for eleven -- Federal Order
18 decision on producer-handlers established:

19 1. The Secretary has clear authority to fully regulate
20 producer-handlers operating within FMMO's.

21 This is a quote:

22 Prior rulemakings consistently articulated USDA's
23 authority to subject producer-handlers to full
24 regulation. For example, in a final decision for
25 the Puget Sound Order, a predecessor to the
Pacific Northwest Order, USDA found that
producer-handlers should continue to be exempt
from pooling and pricing provisions of the order

1 subject to further regulation if justified by
2 prevailing market conditions. This position was
3 amplified in a subsequent producer Sound final
4 decision --

5 JUDGE CLIFTON: Start that sentence again, would you?

6 MR. HOLLON:

7 This position was amplified in a subsequent Puget
8 Sound final decision where USDA found that a
9 hearing should be held to consider the regulation
10 of producer-handlers in the marketing area was
11 susceptible --

12 JUDGE CLIFTON: I'm sorry, you got to do that one again, if
13 you will.

14 MR. HOLLON:

15 This position was amplified in a subsequent Puget
16 Sound final decision, wherein USDA found that in a
17 hearing should be -- that a hearing should be held
18 to consider the regulation of producer-handlers if
19 the marketing area was susceptible to being
20 affected by producer-handlers or if
21 producer-handler sales to disrupt or operate to
22 the detriment of other producers in the market.
23 Such policy decisions was also articulated in the
24 --

25 JUDGE CLIFTON: I know it's a quote, so start that one
again.

MR. HOLLON:

Such policy was also articulated in another
decision concerning producer-handlers in Texas and
the Southwest plains. That decision concluded
that it would be appropriate to obligate
producer-handlers to the pooling and pricing
provisions of the order, if it could be shown that
producer-handlers cause market disruption.
75 Fed. Reg. 10122, 10147, (2010) (footnotes
omitted.)

1 2. The Secretary should apply his conclusions regarding
2 producer-handlers to all FMMO's, including this proposed
3 California FMMO. The 2010 decision noted specifically that
4 establishing reasonable limits on the sales of fluid milk
5 products from producer-handlers meet the policy objectives the
6 Agriculture Marketing Agreement Act (AMMA).

7 BY MR. HOLLON:

8 Q. AMAA.

9 A. AMAA.

10 Q. Thank you.

11 A. The following is a quote:

12 The record supports concluding that a direct
13 relationship exists between producer-handler size
14 and the potential for disorder. More
15 specifically, the record supports the conclusion
16 that adoption of a limit on producer-handlers'
17 total monthly Class I route disposition and sales
18 of packaged fluid milk products to other plants
19 across all orders is necessary to maintain orderly
20 marketing conditions.
21 75 Fed. Reg. At 10151 (2010)

22 Establishing a reasonable limit on total Class I
23 route disposition and sales of packaged fluid milk
24 products in all producer-handler definitions for
25 all Federal Milk Marketing Orders unifies the
policy objective of the AMAA to establish and
maintain orderly marketing conditions.
75 Fed. Reg. At 1015 (2010)

26 That is the end of that quote.

27 The AMAA provides for "payment to all producers and
28 associations of producers delivering milk to all handlers of
29 uniform prices for all milk delivered, irrespective of the uses

1 made of such milk." (7 U.S.C. Section 608c(5)(B)(ii)). The
2 historical exemption for producer-handlers was a matter of
3 administrative convenience, and not a statutory entitlement in
4 the Federal system. As such, a clear limitation on the size of
5 producer-handlers is consistent with, and furthers the express
6 language and purposes of the AMAA.

7 3. The definition of a producer-handler:

8 Producer-handlers are dairy farms that process --
9 I'm sorry, this is a quote -- producer-handlers
10 are dairy farms that process their own milk
11 production. These entities must operate one or
12 more dairy farms as a pre-condition to operating
13 processing plants as producer-handlers.
14 75 Fed. Reg. At 10122 (2010)

15 Producer-handlers are persons who operate dairy
16 farms and generally process and sell only their
17 own milk production. A pre-condition to operating
18 a processing plant as a producer-handler is the
19 operation of a dairy farm.
20 75 Fed. Reg. At 10147 (2010)

21 Nevertheless, the common criteria of all
22 producer-handler definitions for all orders is a
23 requirement that the entire operation be under the
24 sole risk and enterprise of the producer-handler.
25 75 Fed. Reg. At 10146 (2010)

That's the end of this quote.

4. The establishment of uniform prices to producers is a
fundamental objective of FMMOS.

A new quote:

The AMAA requires the setting of uniform prices to
producers regardless of how the milk of any single
dairy farmer is used and uniform prices to
similarly situated handlers (Section 608c(5)).
Handlers who are similarly situated pay at least a

1 the orders for milk. Producers are paid at least
2 a minimum uniform (blend) price that is determined
3 through market-wide pooling. A market-wide pool,
4 through the mechanism of a producer-handler
5 settlement fund, equalizes the classified use
6 values of --

7 Q. Would you start that sentence again, please?

8 A.

9 A market-wide pool, through the mechanism of a
10 producer-settlement fund, emphasize the classified
11 use values of milk --

12 Q. Excuse me, maybe just slow down a tinch and you will
13 catch the words. Go ahead, starred that sentence again.

14 A.

15 A market-wide pool, through the mechanism of a
16 producer-settlement found, equalizes the
17 classified use values of milk pooled on an order
18 among handlers and determines a uniformed price
19 paid to producers. Market-wide pooling allows for
20 equitable sharing of the cost of supplying and
21 balancing the Class I market. These two key
22 features of milk orders, classified pricing and
23 market-wide pooling, provide the basic foundation
24 for orderly marketing and address the AMAA's
25 primary objective of ensuing orderly marketing.
75 Fed. Reg. At 10145-46 (2010)

Continuing the quote:

Over the years, USDA has repeatedly concluded that
market-wide pooling for most orderly marketing
conditions more completely and is one of the most
important marketing tools used to insure
uniformity and prices to producers.
(Footnote omitted.)
75 Fed. Reg. At 10148 (2010)

End of this quote.

5. The operations of producer-handlers can disrupt the
establishment of uniform prices.

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Of greater significance, the record of this proceeding indicates that all producer-handlers enjoy a competitive pricing advantage over fully regulated handlers because of their exemption from pooling and pricing provisions. This is not surprising, as the exemption of any handler from the regulatory plan results in non-uniform prices to handlers and lower prices than would otherwise be uniform to producers. It is clear from this proceeding that as the Class I marketing of a producer-handler increase, the handlers' ability -- to the order's ability --

Q. Excuse me. Thank you.

A.

-- to set prices that are uniform to handlers and producers is eroded.

Depending on the volume of Class I disposition and sales of packaged fluid milk products to other plants, the exemption from obligation to account for milk at minimum classified prices and the exemption from payment into the producer-settlement fund the difference between the producer-handlers use-value of milk and the blend price become critical factors that give rise to disorderly marketing conditions. Large producer-handlers become increasingly able to market fluid milk at prices below those that can be offered by fully regulated handlers because the classified prices set by the order are not uniform. The exemption for payment to the producer-settlement fund renders the order unable to set uniform prices to producers.

...
This final decision emphasizes that when any handler is exempted from pooling and pricing, regulated handlers and producers whose milk is pooled on an order are affected by the by that exemption. Regulated handlers are affected because they are obligated to make pool payments while producer-handlers are not obligated. Producers are also affected because handler exemption results in fewer dollars available in the pool, thus making the uniform price to producers lower. Market Administrator data in the

1 reveals that exclusion of producer-handler revenue
2 affects the total pool value in any Federal Order
3 marking area, where producer-handlers are present.
4 Total pool values are hundreds of thousands of
5 dollars less every month than they would be, which
6 directly translates into lower uniform prices paid
7 to producers. In markets where producer-handlers
8 are not present, no impact on total pool value
9 occurs.
10 75 Fed. Reg. At 10146 (2010)

11 That's the end of this quote.

12 6. The measure of the producer-handler advantage is
13 calculated to be the difference between the Class I price and
14 the blend price. The ability of the producer-handler to retain
15 this value is detrimental to the objectives of all producers
16 receiving the minimum price from the order.

17 Quote:

18 As a result of their exemption from pooling and
19 pricing, producer-handlers, as handlers, are not
20 required to pay the minimum class prices
21 established under the orders, nor are they, as
22 producers, granted minimum price protection for
23 disposal of surplus milk. Producer-handlers, in
24 their capacity as handlers, are not obligated to
25 equalize their use value of milk through payment
of the difference between their use-value of milk
and the respective order's blend price into the
producer-settlement fund. As such,
producer-handlers retain the full value of milk
processed and disposed of as fluid milk products
by their operation within the marketing areas.
75 Fed. Reg. At 10124 (2010)

While opponents to the elimination of the
producer-handler definitions argue otherwise, this
definition agrees with proponent arguments --

Q. Start that sentence again, please.

A.

1 While opponents to the elimination of the
2 producer-handler definitions argue otherwise, this
3 decision agrees with proponent arguments presented
4 by witnesses testifying in support of NMPF and
5 IDFA positions, that the difference between the
6 Class I price and the blend price is a reasonable
7 estimate of the price advantage enjoyed by
8 producer-handlers, even if it is not possible to
9 determine the precise level of the advantage for
10 any individual producer-handler. This price
11 advantage is compounded as a producer-handler's
12 Class I utilization increases. In addition,
13 allowing producer-handlers to have unlimited Class
14 I sales will result in a measurable impact on the
15 blend price received by pooled producers.
16 75 Fed. Reg. At 10147 (2010)

17 That's the end of this quote.

18 7. The Decision concluded that the size of a
19 producer-handler should be a controlling factor in determining
20 the regulatory status of a producer-handler. Quote:

21 Q. Finish that sentence.

22 A. -- of a producer-handler plant.

23 Q. Thank you.

24 A. Quote:

25 The size of individual producer-handlers will
 impact orderly marketing conditions of the Federal
 Order marketing areas if left without --

 JUDGE CLIFTON: I'm sorry, start that one again, please,
 that quote.

 MR. HOLLON:

 The size of individual producer-handlers will
 impact orderly marketing conditions in any of the
 Federal Order marketing areas if left without
 limit. Size of operation will have a direct
 bearing on competitive equity between

1 Producer-handler size, as discussed above, will
2 increasingly affect an order's ability to set
3 uniform prices to similarly-situated handlers and
4 to producers. Producer-handler size will
5 increasingly magnify disorderly marketing
6 conditions and practices where the burden of
7 balancing and surplus disposal is effectively
8 transferred to the regulated market.
9 These examples of the presence and anticipation of
10 disorderly marketing conditions can be largely
11 mitigated by establishing a reasonable limit on
12 producer-handler's Class I route disposition and
13 sales of packaged fluid milk products to other
14 plants.

15 Establishing a reasonable limit on total Class I
16 route disposition and sales of packaged fluid milk
17 products in all producer-handler definitions for
18 all Federal Milk Marketing Orders unifies the
19 policy objectives of the AMAA to establish and
20 maintain orderly marketing conditions.
21 75 Fed. Reg. At 10150 (2010).

22 End of this quote.

23 8. The Decision concluded that total route disposition and
24 sales of packaged fluid milk products to other plants of more
25 than 3 million pounds during the month would cause a
26 producer-handler to be fully regulated and account to the pool
27 for their uses of milk at the applicable minimum class prices
28 and pay the difference between their use value of milk and the
29 blend price of the order to that order's producer-settlement
30 fund.

31 Quote:

32 If current producer-handlers had total route
33 disposition and sales of packaged milk products to
34 other plants of more than 3 million pounds during
35 the month, such producer-handlers will be
36 regulated under the pooling and pricing provisions

1 handlers. Such large producer-handlers will
2 account to the pool for their uses of milk at the
3 applicable minimum class prices and pay the
4 difference between their use value of milk and the
blend price of that order to that order's
producer-settlement fund.

5 JUDGE CLIFTON: Now, the last part of that, if you'd just
6 read that again, beginning with "the blend price."

7 MR. HOLLON: "And the blend price of the order to that
8 order's producer-settlement fund."

9 75 Fed. Reg. At 10122 (2010)

10 That's the end of that quote.

11 9. The Decision noted the change in regulatory status
12 would have economic cost and benefits to the producer-handler
13 and benefits to producers in the form of increased blend
14 prices.

15 This is a quote:

16 While this may cause an economic impact on those
17 entities with more than 3 million pounds of total
18 monthly sales that are currently considered
19 producer-handlers under the Federal Order system,
20 the impact is offset by the benefit to other small
businesses. With respect to dairy farms whose
milk is pooled on Federal Milk Marketing Orders,
such dairy farms who have not heretofore --

21 JUDGE CLIFTON: I know that what you read means the same as
22 what is written here, but because it is a quote, will you start
23 again with "with respect to dairy farms?"

24 MR. HOLLON:

25 With respect to dairy farms whose milk is pooled

1 have not heretofore shared in the additional
2 revenue that accrues from the market-wide pooling
3 of Class I sales by producer-handlers, will share
4 in such revenue. All producer-handlers who
5 dispose of more than 3 million pounds of fluid
milk, including sales of packaged fluid milk
products, to other plants per month, will account
to all market participants at the announced
Federal Order Class I price for such use.

6 To the extent that some large producer-handlers
7 become subject to pooling and pricing provisions
8 of Federal Milk Marketing Orders, such will be
9 determined in their capacity as handlers. Such
10 entities will no longer have restrictions
applicable to their business operations that were
conditions for producer-handler status and
exemption from the pooling and pricing provisions
of the orders.

11 In general, this includes being able to buy or
12 acquire any quantity of milk from dairy farmers or
13 other handlers instead of being limited by the
14 current constraints of the orders. Additionally,
15 the burden of balancing their milk production is
16 relieved. Milk production in excess of what is
17 needed to satisfy their Class I route disposition
18 and sales of packaged fluid milk products to other
plants may receive the minimum price protection
established under the terms of the Federal Milk
Marketing Orders. The burden of balancing milk
supplies will be borne by all producers who are
pooled and handlers who are regulated under the
terms of the orders.

75 Fed. Reg. At 10122-23 (2010)

19 This is the end of that quote.

20 The foregoing clearly establishes that the Secretary of
21 Agriculture has the authority to define and regulate
22 producer-handlers who operate in any capacity. The Secretary
23 should exercise that authority in promulgating the California
24 FMMO and implement regulations similar to those in other orders
25 controlling the action of the large producer-handlers.

1 The establishment of uniform prices for both producers and
2 handlers is a prime objective of FMMO's and the operation of
3 large producer-handlers disrupts this objective. The measure
4 of the disruption can be calculated as the difference between
5 the Orders' announced Class I price and blend price. Any
6 difference between the two prices is evidence of disruption.
7 The size of a producer-handler should be the controlling factor
8 for establishing regulation. For the purpose of establishing
9 which producer-handlers should be fully regulated, the "bright
10 line" of regulation has been determined to be producer-handler
11 plants with 3 million pounds of total route disposition and
12 packaged sales of fluid milk products to other plants during
13 the month. Those above that line become fully regulated.
14 Those below that line will not be fully regulated. The
15 decision noted that there would be cost to the large
16 producer-handler, but that those costs would be offset by
17 benefits to the producer-handler and benefits to the remaining
18 pooled producers.

19 B. Financial Impact of producer-Handlers

20 Table 8.1, Estimated Producer Handler Advantage 2000 -
21 December 2014, demonstrates the impact to the pool based on the
22 definition of producer-handler hearing from the -- start over.

23 Table 8.1, Estimated Producer Handler Advantage, 2000 -
24 December 2014, demonstrates the impact to the pool based on the
25 definition from the producer-handler hearing decision

1 referenced above.

2 Financial Impact = Class I price minus Blend Price

3 I'm going to stop here and go to the table and explain
4 what's in the table and then come back to the testimony.

5 So the table is Exhibit 76, there are four pages in the
6 table.

7 BY MR. BESHORE:

8 Q. Four or are there five pages total counting the --

9 A. Five, yeah, five pages in the table.

10 Q. Thank you.

11 A. The table is entitled Cooperatives' Table 8.1,
12 Estimated Producer Handler Advantage, 2000 - December 2014.
13 The data used here stops in 2014 because that is the last CDFA
14 released data in Column I.

15 Column A is months.

16 Column B is Class I mover.

17 Column C the weighted differential.

18 Column D is the Class I price, B plus C, and these are
19 all using the same data and logic that we used in earlier
20 tables in our proposals.

21 Column E is taken from Exhibit 64, Table 5.C, Column I,
22 top line, Estimated FMMO Blend. And this is simply the
23 appropriate Federal Order class or Federal Order prices, times
24 the utilizations as published by CDFA.

25 Column F takes that top line with no deductions at all,

1 of any form, and reduces it by the quota, transportation, and
2 adds back the RQA, and that is similar in its concept as we did
3 in earlier presentation.

4 Column G is columns D less G. So if -- if every
5 producer-handler were located in the highest differential zone,
6 that would be the Class I advantage, Class I price advantage
7 for that month.

8 Column H does the same type of calculation and
9 subtraction, only this time using the lowest differential zone
10 of \$1.60.

11 Column I is taken from Exhibit 61, CDFA-D, and that is
12 producer-handler exempt Class I product pounds. Since we
13 needed some amount of some volume to give a reasonable
14 estimate, we used that volume for illustrative purposes. We
15 are aware that currently the way California regulates
16 producer-handlers, they are fully accountable to the pool, and
17 that would be, and from that perspective it would be no
18 different than in the future.

19 Column J takes those pounds and multiplies them times
20 the advantage, if everyone was in the \$2.10 zone.

21 Column K takes those pounds and computes the total
22 dollar advantage if everyone were in the \$1.60 zone.

23 We do not have any total pounds from any, from CDFA for
24 all Class I sales. So this is the --

25 Q. All Class I sales of the --

1 A. -- of the --

2 Q. Producer-handler?

3 A. Exempt producer-handlers, that's correct. And again,
4 this is an illustration and example. So all of those
5 calculations run their way through, and the Table 8.1.5, then,
6 is a summary of all of those calculations for the entire
7 period. And also, as we have done with other tables, for a
8 most recent period.

9 So using that explanation of the table and going back
10 to the testimony.

11 JUDGE CLIFTON: Now, pause just a moment. Mr. Beshore, do
12 you want him to expand his testimony at this point on any part
13 of Exhibit 76, the table, before he goes back to his testimony?

14 MR. BESHORE: Nothing beyond what he's already done.

15 JUDGE CLIFTON: Very good. Then going back to Exhibit 75,
16 page 8, is that correct, Mr. Hollon?

17 MR. HOLLON: Yes. So the, I'll be starting at the second
18 full paragraph.

19 Since we do not have producer-handler sales volume
20 data, other than the pounds of exempt Class I sales reported by
21 CDFA, we have used those volumes which would be reflective of
22 certain market conditions but are primarily for illustrative
23 purposes here. Using those numbers, estimates can be made of
24 the per hundredweight price impact based on announced class
25 prices and our estimated blend prices.

1 Multiplying the per hundredweight difference times the
2 volumes used, result in an estimated dollar impact. Based on
3 market commentary from customers in our own operations, we
4 understand that the California producer-handlers have sales
5 volumes in excess of their known sales (based on exempt
6 volumes), thus these results would represent the lower end of
7 any potential impact from these producer-handlers.

8 Column 8 -- I'm sorry -- in Table 8.1 (Column E) we
9 used the monthly blend prices from Exhibit 64, Table 5.C, which
10 we calculated earlier, and reduced the calculation by 43 cents
11 per hundredweight, which represents the estimated per
12 hundredweight cost of the net quota premium payments and the
13 cost of the transportation credit payment. (Column F) This
14 gives us the two numbers necessary to calculate a per
15 hundredweight impact if producer-handlers with more than
16 3 million pounds of total route disposition and packaged sales
17 of fluid milk products to other plants during the month were
18 not regulated.

19 We calculated impacts as if the producer-handlers were
20 located in either the \$2.10 or \$1.60 Class I differential zone.
21 (Columns G and H) For example, if all of the producer-handlers
22 production volume was located in the \$2.10 differential zone,
23 the impact in January 2000 would have been estimated to be
24 \$2.28 per hundredweight. And if all producer-handler milk was
25 locate in the \$1.60 zone, \$1.78 per hundredweight. The average

1 producer-handler per hundredweight advantage for the entire
2 period of 2000 through December 2014, would be \$2.55 for the
3 \$2.10 zone, and \$2.05 for the \$1.60 zone per hundredweight.
4 For a more recent period, August 2012 through December 2014,
5 the averages would be \$2.60 and \$2.10 for the \$2.10 and \$1.60
6 zones.

7 Multiplying the per hundredweight values by the
8 published pounds of exempt Class I use (Column I) yields the
9 dollars listed in Columns J and K. These totals for the period
10 January 2000 through December 2014, average \$539,742.02 per
11 month for the \$2.10 zone, and \$433,795.82 for the \$1.60 zone.
12 These translate into an average blend price impact of \$0.018
13 per hundredweight or one --

14 BY MR. BESHORE:

15 Q. Is that \$0.018 per hundredweight?

16 A. Dollars per hundredweight.

17 Q. Thank you.

18 A. And \$0.014 per hundredweight for the January 2000 to
19 December 2014 period for the \$2.10 and \$1.60 zones,
20 respectively. For the August 2012 through December '14 period,
21 the impact is \$0.016 and \$0.013 for the two zones respectively.

22 Although the data for this analysis is limited, the
23 demonstrated impact meets the standard set out in the final
24 2010 -- no, start over.

25 Although the data available for analysis is limited,

1 the demonstrated impact meets the standard set out in the 2010
2 final decision.

3 Quote:

4 While opponents to the elimination of
5 producer-handler definitions argue otherwise, this
6 definition agrees with proponent arguments --

6 JUDGE CLIFTON: Start again, please.

7 MR. HOLLON:

8 While opponents to the elimination of the
9 producer-handler definitions argue otherwise, this
10 decision agrees with proponent arguments,
11 presented by witnesses testifying in support of
12 NMPF and IDFA positions, that the difference
13 between the Class I price and the blend price is a
14 reasonable estimate of the price advantage enjoyed
15 by producer-handlers even if it is not possible to
16 determine the precise level of advantage for any
17 individual producer-handler. This price advantage
18 is compounded as a producer-handler's Class I
19 utilization increases. In addition, allowing
20 producer-handlers to have unlimited Class I sales
21 will result in a measurable impact on the blend
22 price received by pooled producers.
23 75 Fed. Reg. At 10147 (2010) (emphasis added)

17 And that's the end of that quote.

18 The resulting conclusion is that large size
19 producer-handlers in the proposed California FMMO should be
20 regulated in the same manner as they are in other FMMO's. Our
21 proposal would not require any producer-handler with less than
22 3 million pounds of total route disposition and packaged fluid
23 milk products to other --

24 BY MR. BESHORE:

25 Q. Start that sentence again.

1 A. Our proposal would not require any producer-handler
2 with less than 3 million pounds of total route disposition in
3 packaged sales of fluid milk products to other plants during
4 the month, to account to the pool for milk used at class
5 prices, provided they meet all the requirements. A
6 producer-handler with more than 3 million pounds of total route
7 disposition and packaged sales of fluid milk products to other
8 plants during the month, would have to meet all the
9 requirements of any regulated handler.

10 C. The Cooperatives' proposal

11 The regulatory language for our proposal is as follows:

12 Section 1051.10 Producer-handler.

13 Producer-handler means a person who:

14 (a) Operates a dairy farm and a distributing plant from
15 which there is route disposition in the marketing area,
16 and from which total route disposition in packaged sales of
17 fluid milk products to other plants during the month does
18 not exceed 3 million pounds;

19 (b) Receives fluid milk from own farm production or milk
20 that is fully subject to the pricing and pooling provisions
21 of the order in this part or in any other Federal Order;

22 (c) Receives at its plant or acquires for route
23 disposition, no more than 150,000 pounds of fluid milk
24 products from handlers fully regulated under any Federal
25 Order. This limitation shall not apply if the

1 producer-handler's own farm production is less than
2 150,000 pounds during the month;

3 (d) Disposes of no other source milk as Class I except by
4 increasing the nonfat milk solids content of the fluid milk
5 products;

6 JUDGE CLIFTON: Please read (d) again.

7 MR. HOLLON:

8 (d) Disposes of no other source milk as Class I milk except
9 by increasing the nonfat milk solids content of the fluid
10 milk products;

11 (e) Provides proof satisfactory to the Market
12 Administrator that the care and management of the dairy
13 animals and other resources necessary to produce all
14 Class I milk handled (excluding receipts from handlers
15 fully regulated under any Federal Order) and the processing
16 and packaging operations are the producer-handlers own
17 enterprise and at its own risk; and

18 (f) Any producer-handler with Class I route dispositions
19 and/or transfers of packaged fluid milk products in the
20 marketing area described in Section 1131.2 of this chapter,
21 shall be subject to payments into the Order 1131
22 producer-settlement fund, on such dispositions pursuant to
23 Section 1000.76(a) and payments into the Order 1131
24 administrative fund provided such dispositions are less
25 than 3 million pounds in the current month and such

1 producer-handler had total Class I route dispositions
2 and/or transfers of packaged fluid milk products from own
3 farm production of 3 million pounds or more in the previous
4 month. If the producer-handler has Class I route
5 dispositions and slash/or transfers a package fluid milk
6 products into the marketing area described in Section
7 1131.2 of this chapter of 3 million pounds or more during
8 the current month, such producer-handler shall be subject
9 to the provisions described in Section 1131.7 of this
10 chapter Section 1000.76(a).

11 D. Exempt Quota

12 As stated above, the Cooperatives' Proposal 1 will regulate
13 the current California 'producer-handlers,' whose operations
14 will not comply with the definition of producer-handler as we
15 proposed it. Such regulation, however, does not expressly
16 address the status of exempt quota owned by these entities.

17 With respect to exempt quota, we note:

18 1. Under California law, exempt quota can be sold and
19 continue to have all the entitlements of "regular" quota,
20 including the \$1.70 per hundredweight premium.

21 2. California handlers can own farms and own quota
22 like any other producer, and at least some of the
23 producer-handlers who own exempt quota, also own "regular"
24 quota which they supply to their own distributing plants.

25 The impact of the pool --

1 Q. Number 3?

2 A. Number 3. The impact to the pool of exempt quota at a
3 distributing plant is greater than the impact of other quota,
4 but significantly less than the impact of fully unregulated
5 supplies.

6 4. Transportation credits under Proposal 1, could, and
7 likely would, apply to some deliveries of farm milk presently
8 covered by exempt quota, if that quota was converted to regular
9 quota (although exempt quota is not entitled to transportation
10 allowances under current California law.)

11 The cooperatives are still evaluating these factors with
12 respect to the treatment of exempt quota, which we recognize
13 reflects an investment by its owners. We will continue to
14 evaluate our position on this issue, in light of evidence
15 presented further at this hearing.

16 Q. Could you stop there and go back to number 3, under
17 exempt quota. And for clarification, when you reference in the
18 final clause, "fully unregulated supplies," do you mean
19 basically non, supplies of non-quota milk?

20 A. I'm sorry, repeat that.

21 Q. Okay. Number 3 says, "The impact to the pool of exempt
22 quota at a distributing plant is greater than the impact of
23 other quota, but significantly less than impact of non-quota
24 supplies."

25 Is that what fully unregulated means there?

1 A. Yes.

2 Q. Okay. Thank you. Now, I would propose that we go
3 ahead, Mr. Hollon, and read the, you know, the opening
4 paragraph on Exhibit 77.

5 JUDGE CLIFTON: I would propose we take a break.

6 MR. BESHORE: That's completely acceptable, your Honor.

7 JUDGE CLIFTON: This is a lot to digest. It will give
8 everybody a chance to digest what's in 75. But before we
9 break, I would like to take the appearance of both Mr. Carman
10 and Mr. English. Both were here for very much of Mr. Hollon's
11 testimony thus far, but I just want them to identify
12 themselves.

13 MR. CARMAN: Good morning, your Honor. Clifford Carman,
14 C-A-R-M-A-N, Assistant to the Deputy Administrator, Dairy
15 Programs.

16 JUDGE CLIFTON: Thank you.

17 MR. ENGLISH: Good morning. Thank you, your Honor. Chip
18 English, C-H-I-P, E-N-G-L-I-S-H, on behalf of the Dairy
19 Institute of California. And I apologize that I was, for the
20 first time in four weeks, unavoidably detained on another
21 matter when we started.

22 JUDGE CLIFTON: No apology necessary. I think it's been
23 amazing how people have been able to juggle their regular job
24 with the demands of this hearing.

25 All right. Let us take a 15-minute break, and I would

1 like you to be back and ready to go, at 10:35. 10:35.

2 (Whereupon, a break was taken.)

3 JUDGE CLIFTON: Back on record at 10:36. Mr. Beshore?

4 MR. BESHORE: Thank you, your Honor. Marvin Beshore.

5 BY MR. BESHORE:

6 Q. Okay. Mr. Hollon, before we go to the paragraph on
7 page 77, Exhibit 77, at the break we noted that a few
8 inaccuracies crept into the column references on Exhibit 76,
9 Table 8.1. So can you identify those so we can correct them
10 now before cross-examination?

11 A. On Table 8.1, Column G should read D minus F.

12 Q. And that's the, sort of the function performed in each
13 cell in each row in that column?

14 A. Correct. Column H should read, G minus \$0.50.

15 Q. Rather than H minus 50?

16 A. Correct. Column J should read G times I, divided by
17 100. And Column H should be --

18 Q. K?

19 A. I'm sorry, Column K should be H times I, divided by
20 100, with the parentheses in the appropriate spots, that
21 wouldn't change.

22 Q. Okay. So those are just corrections to the function at
23 the top of each of those columns, G?

24 A. That's correct.

25 Q. H, J, and K, and that would apply on each page, 1

1 through --

2 A. 5.

3 Q. 5, of Table 8.1, Exhibit 76.

4 A. That's correct.

5 Q. Okay. Thank you. Now, would you read the --

6 JUDGE CLIFTON: Now, before he goes there. That's tiny,
7 and Ms. Elliott, I would like you to make the changes on the
8 record copy of Exhibit 76, and I just suggest you use the
9 space, the wide space above those column headings, because
10 otherwise you are not going to have room to write. So do you
11 need Mr. Hollon to identify those again?

12 MS. ELLIOTT: No, I wrote them down.

13 JUDGE CLIFTON: All right. Excellent. If you have any
14 hesitancy at all about it, you may show that to Mr. Hollon at a
15 break, show him what you have done and confirm that it captured
16 what he intended. All right? Thank you, Mr. Beshore, now you
17 may redirect us.

18 BY MR. BESHORE:

19 Q. Okay. Let's go to 77, and read the first full
20 paragraph at the top of the first page.

21 A. PROPOSAL 1 PROVISION FOR PAYMENTS BY A HANDLER
22 OPERATING A PARTIALLY REGULATED DISTRIBUTING PLANT

23 The Cooperatives propose that the California Milk
24 Marketing Order adopt the uniform language, Section 1000.76, as
25 part of 1051.76, to determine payments --

1 JUDGE CLIFTON: I'm sorry, is that "as part" or is it "as
2 part of?"

3 MR. HOLLON: As part -- I understand. Let's start over
4 again.

5 The Cooperatives propose that the California Milk
6 Marketing Order adopt the uniform language of Section 1000.76
7 as part 1051.76 to determine payments to be made to the pool by
8 partially regulated distributing plants. Those plants which
9 have route disposition in the marketing area in quantities less
10 than 25 percent of their total route disposition.

11 JUDGE CLIFTON: Now, when you read that, you didn't tell us
12 what kind of plants.

13 MR. HOLLON: Those Class I plants which have route
14 disposition in the marketing area in quantities less than 25
15 percent of their total route disposition. Mr. Wise earlier
16 testified as to how this language operates. We support and
17 endorse that testimony and request that the uniform language
18 which follows in full below, and is in operation in all Federal
19 Orders, be adopted for the California Order.

20 MR. BESHORE:

21 Q. Okay. Now, Mr. Hollon, we're not going to ask you to
22 read Section 1000.76 --

23 A. That is wonderful.

24 Q. -- which is part of Exhibit 77, but we, it is part of
25 that exhibit for convenient reference with your testimony and

1 for any questions anyone might have with respect to that.

2 With that, your Honor, I would move for the admission
3 of Exhibits 20A, 75, 76, and 77. And Mr. Hollon is available
4 for questions by other parties.

5 JUDGE CLIFTON: I like the way you handled that.
6 Excellent. Is there any objection to the admission into
7 evidence of Exhibit 20A? There is none. Exhibit 20A is
8 admitted into evidence.

9 (Thereafter, Exhibit 20A was
10 received into evidence.)

11 JUDGE CLIFTON: Is there any objection to the admission
12 into evidence of Exhibit 75? There is none. Exhibit 75 is
13 admitted into evidence.

14 (Thereafter, Exhibit 75 was
15 received into evidence.)

16 JUDGE CLIFTON: With regard to 76, I just comment that the
17 corrections that will be made to the record copies will need to
18 be made on each page of the table. So, small item, I think
19 everybody knew what he meant even before he relabeled them, but
20 we do need to make those corrections.

21 Is there any objection to the admission into evidence
22 of Exhibit 76? There are none. Exhibit 76 is admitted into
23 evidence.

24 (Thereafter, Exhibit 76 was
25 received into evidence.)

1 JUDGE CLIFTON: Is there any objection to the admission
2 into evidence of Exhibit 77? There are none. Exhibit 77 is
3 admitted into evidence.

4 (Thereafter, Exhibit 77 was
5 received into evidence.)

6 JUDGE CLIFTON: Who first will question Mr. Hollon?
7 Mr. English?

8 CROSS-EXAMINATION

9 BY MR. ENGLISH:

10 Q. Good morning, Mr. Hollon. Chip English.

11 A. Good morning, Mr. English.

12 Q. So let me start in little bit reverse order and look at
13 Exhibit 77.

14 A. Okay.

15 Q. And this is, I have to assure you, is curiosity, partly
16 curiosity, I'm trying to understand how it works.

17 So -- and I'm going to focus on the Wichita option,
18 which is Paragraph B, correct? On 76 -- Section 76?

19 A. That's correct.

20 Q. Wichita option? So if a plant located, obviously
21 outside of the state because of the way you defined plants, has
22 route disposition less than 25 percent into California, so that
23 it is partially regulated, correct?

24 A. Correct.

25 Q. Okay. How, if at all, does California's, or your

1 proposed California Federal Milk Order quota system impact that
2 partially regulated plant's obligation, calculated under the
3 Wichita option?

4 A. You would have the, whatever the plant pays, the
5 outside-the-area plant pays its milk supply, compared to the
6 class, let's see, the plant blend calculation, if you will, of
7 the handler. And compare those two values, and if the handler
8 elects that option, it would pay that into the pool.

9 Q. Well, now, I remember under B you don't pay under in
10 the pool.

11 A. You are correct.

12 Q. Under B what you are doing is proving to the Market
13 Administrator that your plant blend price would be equal or
14 greater than what your obligation would be if you were a fully
15 regulated plant.

16 A. You are correct.

17 Q. Okay. So, and again, I think the answer may very well
18 be the quota program doesn't implicate it, but I think, you
19 know, in a way we're writing legislative history and what your
20 intentions are, and so I am just trying to make sure that my
21 assumption is correct. That --

22 A. I don't see a spot where in those two calculations what
23 they pay, what the plant paid for, to its milk supply and what
24 the plant blend was on a quota component.

25 Q. Okay. So you agree with me that you don't intend

1 paragraph 76(b), to, for the quota program to impact that
2 calculation?

3 A. As it's currently written in our proposal, no.

4 Q. Wait a minute, was that a yes you agree with me, or no
5 it's not included? I think you may have answered no, but my
6 question was intended to elicit a yes if you agree with me.

7 JUDGE CLIFTON: Ask your question again, Mr. English,
8 artfully.

9 MR. ENGLISH: I thought it was artful the first time, your
10 Honor.

11 JUDGE CLIFTON: It may well have been. It may well have
12 been.

13 BY MR. ENGLISH:

14 Q. Do you agree with me that as written, the impact of
15 quota in a California Federal Order program would not affect
16 the calculation under 76(b)?

17 A. Yes.

18 Q. All right. Now, one more piece of that. In
19 calculating the obligation for a partially regulated plant,
20 would the allowance for fortification figure into the
21 calculation for what that plant would have, since that plant
22 selling in California is going to have to meet the fluid milk
23 standards in California?

24 A. We haven't fully considered that as a possibility yet.
25 So it may or it may not, we don't have a position on that as of

1 yet.

2 Q. Okay. Do you have a view as to how the language is
3 drafted presently, assuming you never have a view about the
4 hearing, what it means in respect to the fortification
5 allowance issue?

6 A. I would say currently that the partially regulated
7 plant not located in the state would not receive a
8 fortification allowance.

9 Q. All right. So going to Exhibit 76, which is your
10 calculations, and you indicated that CDFA did not provide
11 information, certainly monthly information, beyond December
12 2014 in order to make this calculation, correct?

13 A. Correct.

14 Q. Nonetheless, if we do have information -- so Exhibit 61
15 introduced by CDFA, table AC, that was the very last page of
16 Exhibit 61, and it was the Class I Pool Utilization Milk Fat
17 SNF, Other Pool Statistics for August 2015 and Annual 2014, if
18 that information lists the information that you are missing in
19 Column I, just a month of August 2015, you could do that same
20 calculation from the materials in the record, correct?

21 A. Yes, so there's more, if there's pounds available to
22 extend Column I, then I think everything else is in the record.

23 Q. Okay. Thank you. So now discussing your testimony on
24 Exhibit 75 and your discussion about producer-handlers. I only
25 have a few questions.

1 First, have you -- I think this may go back to, I think
2 I asked you, but it may have been another witness -- you know
3 that the language that the Cooperatives propose in Proposal 1
4 is different from the Dairy Institute of California's language,
5 correct? For this provision, producer-handler?

6 A. Yes, I think that's correct.

7 Q. You, in essence, as I recall, took the language from
8 Order 30, The Upper Midwest?

9 A. Correct.

10 Q. You're aware of language in Orders 124 of the Pacific
11 Northwest and 131, Arizona, that is different, correct?

12 A. Yes.

13 Q. Okay. Would you agree with me that that language that
14 appears in Orders 124 and 131 were developed after years of
15 experience with producer-handlers out West that were unique
16 marketing conditions with respect to the size of
17 producer-handlers out West?

18 A. I don't have any information to agree with you or
19 disagree with you on that.

20 Q. Do you know that those provisions are designed to
21 insure that with large -- smaller than 3 million pounds,
22 obviously, in this case -- but with larger producer-handlers,
23 there can be or has been in those orders, circumstances where
24 cows have been moved and other kinds of transactions engaged in
25 in order to maintain the producer-handler status that would be

1 allowed under Order 30, but not under 124 and 131?

2 A. I don't recall if that were the case or not, either
3 way, sorry.

4 Q. Given the history of producer-handlers West of the
5 Rockies, have you considered, as opposed to the Order 30
6 language, the language that the Dairy Institute of California
7 proposes, which is more similar to 124 than 131?

8 A. We have not.

9 Q. Okay. Is that something that you might consider and
10 have more of a different, or an additional opinion, or with
11 respect to that after you hear the Dairy Institute proposal?

12 A. We remain open-minded.

13 Q. Okay. So going to page 11, and I know that Mr. Beshore
14 asked you a question about paragraph 3, and even after he asked
15 the question, I admit that I still am not sure I understand
16 what you are trying to say in paragraph 3.

17 JUDGE CLIFTON: What page again, Mr. English?

18 MR. ENGLISH: I'm on page 11 of Exhibit 75.

19 JUDGE CLIFTON: Thank you.

20 BY MR. English:

21 Q. And I'm looking at D, exempt quota, and the paragraph 3
22 which says, "the impact of the pool of exempt quota at a
23 distributing plant is greater than the impact of other quota,
24 but significantly different than the impact of fully
25 unregulated supplies."

1 And I'm merely trying to understand what that statement
2 means, and if he wants to expand it?

3 A. I think the only inference there is that on a per unit
4 basis, those values are different. Quota carries \$1.70 per
5 hundredweight as a value, and as our calculations here just as
6 an example, in January of 2000, the Column G was \$2.28 per
7 hundredweight, and Column H, \$1.78. So there are differing
8 values that are part of the overall consideration, nothing more
9 than that.

10 Q. And I thank you, and I just didn't tie that together,
11 and that helps me. Thank you.

12 So you are tying page 11 together, that paragraph 3, to
13 the analysis you did in Exhibit 76, and then your discussion on
14 the top of page 9?

15 A. Attempting to do that, correct.

16 Q. Thank you. Now, you participated, you, yourself
17 participated in the National Hearing on Producer-handlers?

18 A. I did.

19 Q. And you support what the Department did as a result of
20 that proceeding, correct?

21 A. Correct.

22 Q. So do you recall that part of that proceeding was a
23 proposal submitted as an alternative proposal, which would, for
24 want of a better phrase, allow a soft cap? That is to say, for
25 producer-handlers more than 3 million pounds, they would be

1 regulated only on the pounds more than 3 million and would be
2 exempt on the volumes 3 million or lower?

3 A. I do recall that.

4 Q. And your organization opposed that solution, correct?

5 A. Correct.

6 Q. Is there a functional difference other than the volume,
7 between that proposal in the National Hearing and exempt quota?

8 A. I don't think there is.

9 Q. So on pages 11 and 12 you indicate that you still
10 haven't developed an opinion, or a final opinion, with respect
11 to the treatment of exempt quota; is that correct?

12 A. That is still true.

13 Q. So what information do you still need now to reach a
14 conclusion as to that?

15 A. We're waiting to hear the testimony of, on those
16 proposals that's yet to come.

17 Q. And I'm now done with 75 and 76.

18 You might want to go to 20A. And comparing it to
19 Exhibit 20, do you have Exhibit 20 with you as well?

20 A. No, I don't, I just have 20A.

21 Q. Okay. If he can have Exhibit 20.

22 JUDGE CLIFTON: Is anybody still looking for their
23 Exhibit 20 or are you ready to go forward? Looks like
24 everybody's caught up, so you may proceed.

25 /////

1 BY MR. ENGLISH:

2 Q. So I want to look at Table 1.B.4 of Exhibit 20 and
3 1.B.4 of Exhibit 20A.

4 A. Okay.

5 Q. Okay. And it's a bit of a picky point, but you have
6 indicated that you highlighted where there was changes,
7 correct?

8 A. Yes.

9 Q. On Exhibit 20A? So I think we actually discussed, and
10 indeed I think you have changed the data for June 2013, which
11 is on that same page, 1.B.4. And I think the data for Class I
12 Southern California is different on 20A than 20.

13 A. Yes.

14 Q. So to the extent that you, just the extent the record
15 says you highlighted changes, that particular line was probably
16 inadvertently not highlighted, correct? Because that changes,
17 from Column H, in original Exhibit 20 is \$20.40, and on 20A it
18 is \$21.12, correct?

19 A. I'm sorry, do that again.

20 Q. I'm looking at June 2013, comparing Exhibit 20, Table
21 1.B.4 to Exhibit 20A, Table 1.B.4, and I'm looking at Column H,
22 which is the Class I for Southern California, which it is
23 listed as \$20.40 in Exhibit 20, but you have corrected -- and I
24 agree with your number -- \$21.12 in 20A?

25 A. You are correct.

1 Q. And then similarly, for Columns I and J, which are
2 based off of Column H, those numbers have gone from negative 63
3 cents, to positive 9 cents; and from negative 53 cents to
4 positive 19 cents, correct?

5 A. You are correct.

6 Q. Okay. So all I was trying to clarify for the record
7 was, to the extent somebody later looks at this and says, okay
8 all I have to do is look at the highlighting, that you
9 inadvertently did not highlight June 2013, correct?

10 A. That is correct.

11 Q. But regardless, that number would have flowed through
12 to your later calculations?

13 A. It would.

14 Q. Yes. That's all I have, Mr. Hollon, thank you very
15 much.

16 A. You are very welcome.

17 CROSS-EXAMINATION

18 BY MS. HANCOCK:

19 Q. Nicole Hancock.

20 Mr. Hollon, can you turn to Exhibit 76? This is your
21 table, Estimated Producer-handler Advantage.

22 A. Yes.

23 Q. Help me -- I guess I'm still not clear on exactly what
24 numbers you are calculating here. Are you using the Option 66,
25 exempt producer-handlers from the California State Order --

1 A. You mean --

2 Q. -- program?

3 A. Whatever is in Column I.

4 Q. In Column I. Thank you.

5 A. Those were numbers that were published by CDFA as
6 exempt handler pounds. I don't recall if their column heading
7 had an option label on it.

8 Q. What is your understanding of what you are calculating
9 here?

10 A. That this is the Class I pounds of producer-handlers
11 with exempt quota.

12 Q. So would that include both the exempt quota holders
13 under Option 70 and the exempt?

14 A. I'm not certain, I would have to go back and ask CDFA
15 what they put in their column. I thought it was just the
16 producer-handlers with exempt quota, but that's in Exhibit 61,
17 the table labeled CDFA-D.

18 Q. Okay. I'm going to have to go back and take a look and
19 see.

20 Did you conduct any kind of analysis or calculations
21 with respect to the valuation of the exempt quota that's held
22 by the producer-handlers, the Option 70 exempt quota?

23 A. I think all of those, all of those that were part of
24 our testimony were conducted by Mr. Hatamuya, whatever he would
25 have said would be what we did in that light.

1 Q. Okay. So just so the record's clear on that,
2 Mr. Hatamuya, in the expert calculations that he conducted and
3 the valuations that he testified to, you still maintain that
4 those are the positions of the Cooperatives?

5 A. Whatever his testimony was would be the position of the
6 group, yes.

7 Q. Okay. So nothing that you are saying in here is a
8 departure from what he's saying, according to your testimony?

9 A. No.

10 Q. Okay. No it's not a departure?

11 A. No, it's a departure.

12 Q. I think I asked a double negative?

13 A. We're not abandoning Mr. Hatamuya, how's that?

14 Q. Okay. That's better. Thank you.

15 Would you agree with me that quota is a statutory
16 entitlement?

17 MR. ENGLISH: Objection, she's asking for a legal
18 conclusion.

19 JUDGE CLIFTON: The objection is noted, but that was
20 Mr. English, his objection to that legal conclusion is noted.
21 The witness may answer the question.

22 MR. HOLLON: I think quota is a construct of California
23 laws.

24 BY MS. HANCOCK:

25 Q. So it's a benefit that's afforded to quota holders

1 because of the statutory language?

2 A. Yes, I think that was all covered in earlier testimony.

3 MR. ENGLISH: Chip English, same objection.

4 JUDGE CLIFTON: Yes. And the objection is noted, and a
5 cautionary tone now sounds.

6 MS. HANCOCK: I didn't hear that, your Honor.

7 JUDGE CLIFTON: I said a cautionary tone now sounds. I'm
8 using Mr. English's objection to the witness' statement as a
9 caution to the Agricultural Marketing Service.

10 MS. HANCOCK: Give me just one second, your Honor.

11 BY MS. HANCOCK:

12 Q. I want to turn to Exhibit 75, page 7.

13 A. Okay.

14 Q. And you were talking about the ruling on the
15 producer-handler hearing from 2010, and the conclusions made by
16 the Secretary of Agriculture in the last full paragraph on
17 Page 7, second sentence, you say, "the measure of disruption
18 can be calculated as the difference between the Order's
19 announced Class I price and blend price. Any difference
20 between the two prices is evidence of disruption."

21 Do you see that?

22 A. I do.

23 Q. Okay. The same would be true, not the same would be
24 true -- let me say that differently.

25 What that's saying is that the amount that's not in the

1 pool because of the exemption treatment, is the amount that's
2 quantified for purposes of determining the disruption?

3 A. I think that's the -- try that one more time.

4 Q. So it's the amount that the pool has been reduced as a
5 whole because the producer-handlers have an exemption from the
6 pool that is used to calculate what is valued as the disruption
7 or the amount that was determined to be a disruption. Is that
8 fair?

9 A. I think the, if you back up one or two of the
10 paragraphs in the testimony, the Secretary said the difference
11 between the Class I price and the blend is a reasonable way to
12 say what that, say that what difference is. And so if some
13 Class I value doesn't get in the pool, then there would be a
14 bigger difference.

15 Q. Okay. So because I'm just trying to make sure that I
16 understand how that, what the effect is. So, in essence, it is
17 a, it's an amount that the pool has been reduced by because the
18 Class I payments haven't been calculated through the pool; is
19 that right?

20 A. All the Class I value doesn't make it to the pool
21 because of the exemption.

22 Q. Okay. So the net effect is that the pool is then
23 reduced by those amounts?

24 A. The pool doesn't get those amounts. If it got it, it
25 would be higher. If it doesn't, in this case, in this example

1 or this definition, it doesn't get it, so it's lower.

2 Q. Okay. Thank you.

3 And under the proposal for preservation of the quota
4 system, the same would be true, then, that amounts that are
5 paid out for quota premiums has the net effect of reducing the
6 rest of the blend price for the pool?

7 A. It would.

8 Q. Okay. And but the proposal the Cooperatives have is to
9 reserve the treatment for that exempt quota because of the
10 language that's come out of the Farm Bill, which, and the
11 Secretary's direction, to preserve at least the value of the
12 quota system. That's the Cooperatives position, right?

13 A. I was waiting to see if Mr. English was going to
14 object.

15 Q. I'm asking about your position, not about an
16 interpretation.

17 MR. ENGLISH: Well, if you are looking for me to object, I
18 will.

19 MR. HOLLON: I was just giving you an opportunity.

20 MR. ENGLISH: I object, it calls for a legal conclusion.

21 JUDGE CLIFTON: Thank you, Mr. English, your objection is
22 noted.

23 Ms. Hancock, can you do your question again, please?

24 MS. HANCOCK: I don't know, your Honor, I got distracted.
25 I tried to craft it in a way that it didn't ask for a legal

1 conclusion.

2 BY MS. HANCOCK:

3 Q. What I'm just asking is for clarification that there
4 are some reasons why the Cooperative believes that it would be
5 acceptable, the Cooperatives as a whole, the Proposal Number
6 1 -- let me start the whole thing over again.

7 JUDGE CLIFTON: Now, let me just say two things. You can
8 always ask this witness's opinion, as you were you starting to
9 do. You can also ask his opinion on matters that call for a
10 legal conclusion because I'm allowing him to answer that.

11 I'm noting Mr. English's objection, but it doesn't
12 change the fact that the witness may respond to your question.
13 So you don't have to word your question with the objection, to
14 avoid the objection, you are welcome to word it however you
15 want.

16 MS. HANCOCK: Thank you, I appreciate that. I'm trying to
17 make a really clean question. I like clean questions and
18 answers, but it has to build in so much to it, so I appreciate
19 that.

20 BY MS. HANCOCK:

21 Q. My question to you is, is it's the Cooperatives
22 position that in Proposal Number 1, that there are, even though
23 preserving the quota system would result in a reduced blend
24 price for other producers, that there is a justification for
25 that that would warrant its preservation?

1 A. Our proposal preserves the value of quota. Proposal
2 Number 1 does that.

3 Q. Which has the net effect of reducing the blend price
4 for other producers?

5 A. It does.

6 Q. Okay. And but that's justified because of the
7 historical treatment for the quota and the quota system; is
8 that right?

9 A. Earlier witnesses provided several justifications, that
10 was one. I don't remember all the ones they provided, but that
11 was one.

12 Q. You understand under the current California State Order
13 system that the Option 70 producer-handlers that I represent,
14 are regulated handlers, correct?

15 A. I do.

16 Q. And they actually do report to the pool for their
17 entire production and processing volumes?

18 A. I'm not sure if I understand it the way you said it,
19 but I think I understand the way that you meant it.

20 Q. Well, help me restate it so that it is clear on the
21 record.

22 A. That they do report, and the amount that is exempted is
23 not included in their total.

24 Q. As the final calculation it's not included in their
25 total.

1 A. Correct.

2 Q. But they report those volumes to the pool and then
3 those amounts are deducted back out.

4 A. That's the way I understand the operation. I'm not
5 entitled to see it, but that's the way I think the operation
6 works.

7 Q. Okay. So different than the producer-handlers that
8 were being addressed in the producer-handler hearing, which in
9 those instances they didn't report to the pool at all.

10 A. You are correct.

11 Q. Okay. But in this instance, it's a fully transparent
12 process where they are fully, they are fully regulated, but
13 then there's exemptions that allow them to deduct certain
14 volumes from their pool calculations.

15 A. Yes.

16 Q. I want to turn to page 11 of Exhibit 75, and in there
17 you have a statement under the first full paragraph under
18 Section D, Exempt Quota. The second to the last sentence in
19 that first paragraph says, "such regulation, however, does not
20 expressly address the status of exempt quota owned by these
21 entities." And I just want to clarify what you mean there.
22 When you say such regulation, you are referring back to the
23 producer-handler regulations that were adopted in 2010; is that
24 right?

25 A. Yes.

1 Q. Okay. So you're distinguishing, you are making a
2 distinction here that the producer-handler exemption that you
3 talked about in the preceding ten pages of Exhibit 75, were
4 talking about the producer-handler definitions that are
5 proposed by the Cooperatives and not talking about exempt quota
6 at that point.

7 A. Correct.

8 Q. And I just want to clarify, too, with the status under
9 the California State Order system as it sits today, the
10 proposal that the Cooperatives' making for producer-handler
11 definition would actually expand the number of
12 producer-handlers that would qualify for the exemption
13 treatment under your definition. Is that your understanding?

14 A. Yes.

15 Q. So whereas some producer-handlers in California are not
16 receiving an exemption, under the Cooperatives' proposal, they
17 would then qualify?

18 A. Correct.

19 Q. Have you conducted an analysis or calculated the impact
20 that that would cause on the pool by exempting out those
21 producer-handlers?

22 A. I have not. I don't have any data.

23 Q. And that's because it's proprietary information, right?
24 We don't have access from the CDFRA as to who would qualify, who
25 would not?

1 A. There's no, as far as I know, there's not published
2 data on those pounds.

3 Q. But you would agree that under the Cooperatives'
4 proposal, that it would reduce the volumes of milk that would
5 be calculated in the pool because there would be exemptions
6 allowed under, for the producer-handlers that qualified for the
7 3 million pounds per month or less?

8 A. Yes.

9 Q. Okay. So separate from that qualification, I want to
10 now turn back to page 11 on Exhibit 75, which is the exempt
11 quota treatment.

12 Under your first paragraph there on page 11, number 1
13 states, "under California law, exempt quota can be sold and
14 continue to have all of the entitlement of "regular" quota,
15 including the \$1.70 per hundredweight premium."

16 Do you see that?

17 A. Yes, I do.

18 Q. Are you referring there to if quota is preserved, or
19 let me say that differently. Are you referring there that if,
20 for example, the producer-handlers who have exempt quota were
21 to transfer it or sell that quota, it would then be converted
22 to regular quota, right?

23 A. That's the way I understand it.

24 Q. And if it was treated as regular quota, it would have
25 that \$1.70 per hundredweight premium. Is that what you are

1 talking about there? If that, for whatever reason exempt quota
2 was converted to regular quota, it would then be subject to the
3 same premium pricing?

4 A. Yes.

5 Q. Okay. But that statement there that you have under
6 Section 1, does not recognize the value above and beyond the
7 treatment of regular quota that exempt quota receives, right?

8 A. Try that again.

9 Q. Well, Dr. Erba and Mr. Hatamuya both testified that
10 exempt quota has a value above and beyond that of regular
11 quota. Do you recall that?

12 A. Yes.

13 Q. But there's, that there's value for trading regular
14 quota, there's value for the premium pricing for regular quota,
15 but then above and beyond those two valuations, exempt quota
16 has an additional economic value, right?

17 A. Yes.

18 Q. So what, I'm just trying to clarify is that under
19 number 1, when you say that exempt quota could be sold and
20 continue to have the regular quota values, this doesn't
21 recognize that there is an exempt value above and beyond that
22 of regular quota?

23 A. That's true.

24 Q. Okay. And I want to talk about paragraph 3, and not to
25 beat it to death, but because I just want to clarify the line

1 that we're drawing here. The sentence says, "the impact to the
2 pool of exempt quota at a distributing plant, is greater than
3 the impact of other quota, but significantly less than the
4 impact of fully unregulated supplies."

5 Do you see that?

6 A. I do.

7 Q. Is fully unregulated supplies, would that be like an
8 Option 66 producer-handler or a fully exempt producer-handler?

9 A. Yes, it could be.

10 Q. Is that, so you are saying it, it might be more than,
11 it would have a greater impact than regular quota, but not as
12 great of an impact as a fully exempt producer-handler's
13 treatment?

14 A. That could be true. And it also refers to, in answer
15 to Mr. English of per unit comparison.

16 Q. Okay. But you haven't done any kind of comparison
17 between the regular quota impact and the exempt quota impact
18 difference, have you?

19 A. No.

20 Q. And under paragraph 4 it talks about the transportation
21 credits under Proposal 1. And I think you have clarified in
22 here, but I just want to make sure that the record's clear.

23 So exempt quota holders do not qualify for any kind of
24 transportation credits or allowances for that volume of milk;
25 is that right?

1 A. Under the California system?

2 Q. Under the California system.

3 A. Yes, that's correct.

4 Q. And then, have you, if, for example, the Cooperatives'
5 proposal were adopted, and the exempt quota holders quota were
6 treated as regular quota, would they then qualify for
7 transportation credits or allowances?

8 A. Under the Cooperatives' proposal it would, under the
9 Federal Order rules.

10 Q. And have you conducted an analysis with respect to the
11 net effect on the pool by then bringing in the exempt quota,
12 but then paying back out transportation credits or allowances?

13 A. I don't have any numbers on that.

14 Q. Has your team evaluated the impact on the pool?

15 A. We have done some calculations to try to figure out
16 what our position is, but we haven't, we haven't completed
17 those or even determined if we captured all the values, yet.

18 Q. And you have, in your discussions, or in your
19 calculations that you have made, what is it that you know, or
20 what do you understand to be the effect on the pool, though?

21 A. Those are things that will fall into page 12, the last
22 paragraph, that we continue to evaluate our position. So I
23 don't have anything to share for the record at this time.

24 Q. So assuming that the Cooperatives' proposal, or
25 assuming that the California Producer Handlers proposal to

1 preserve exempt quota as part the preservation of the overall
2 quota system were to be grafted in a way that didn't have any
3 other impacts on, any other unintended impacts on any other
4 areas other than to just preserve the exempt quota, the
5 Cooperatives remain open and willing to evaluating that
6 language and the adoption proposed by the Producer Handlers
7 Association?

8 A. At this point, we are waiting to hear future
9 testimonies and will decide what to do at that point.

10 Q. Mr. English asked you if there was a functional
11 difference between the soft cap that was proposed in the
12 producer-handler hearing and the exempt quota, and you said you
13 didn't know if there was.

14 Do you recall that?

15 A. I do.

16 Q. But there is a difference, right? Because the exempt
17 quota is part of the quota system, right?

18 A. It is.

19 Q. And in the soft cap proposal, there was no quota system
20 that was addressed in the producer-handlers hearing, right?

21 A. You want to describe your definition of the soft cap
22 proposal so I can make sure I understand it?

23 Q. Well, I'm just using the language that Mr. English
24 used. In the producer-handler, in the producer-handler hearing
25 that was decided in 2010 and you discussed in your testimony,

1 there was a proposal for a soft cap that would allow exemptions
2 up to the 3 million pounds per month threshold, and then have
3 the regular fully regulated treatment for anything beyond that,
4 right?

5 A. I think there were -- there were certain pounds that
6 were exempted, that was the definition of soft cap. It didn't
7 apply to all pounds.

8 Q. Okay. And in that -- in that producer-handler hearing,
9 nobody ever talked about quota in that instance, right?
10 Because there was no quota at issue in any of those Federal
11 Orders?

12 A. Well, I don't recall all, but I think the decision
13 perhaps even mentions the comparison of California soft caps
14 and quota. I think that if you go back and read that decision,
15 there is some language there. But my response to Mr. English
16 was in terms of a financial calculation, and no other. And so
17 the financial way you would look at a soft cap, that there's
18 some value captured and some value not. And the idea that, as
19 we talked a few minutes ago, about how California today creates
20 that, that there is some value captured and some value not.
21 That was my answer to him. That in terms of that financial
22 calculation and limits, I don't see that there's a difference.
23 There's some value captured and there's some value not. To
24 expand it to does it include quota or does it include
25 California law, that wasn't my intent. That wasn't what I

1 thought he was asking and that wasn't what I was answering.

2 Q. Okay. So to be clear, you were -- you were not trying
3 to say that exempt quota is one in the same with the soft cap
4 treatment in the producer-handler hearing, you were talking
5 about the financial calculations or for the treatment of the
6 two?

7 A. Yes.

8 Q. That's all I have, thank you.

9 JUDGE CLIFTON: Who has questions for Mr. Hollon?

10 CROSS-EXAMINATION

11 BY MR. RICHMOND:

12 Q. Bill Richmond, USDA.

13 Thank you, Mr. Hollon for your testimony. I think
14 we're pretty clear in regards to what your proposal is seeking
15 to do, although we are very interested in hearing your position
16 on what to do with exempt quota as we proceed. That's all we
17 have. Thank you.

18 A. I think Ms. May indicated there would be some time to
19 do that.

20 Q. We appreciate that.

21 JUDGE CLIFTON: Are there any other questions for
22 Mr. Hollon at this time?

23 Mr. Beshore, would you come back to the podium? Is
24 this the last of Mr. Hollon's testimony during your
25 case-in-chief?

1 MR. BESHORE: This is the last of Mr. Hollon's testimony
2 during our case-in-chief.

3 JUDGE CLIFTON: Now, with that in mind, folks, does anyone
4 have any questions for him? No one.

5 Mr. Beshore, do you have any redirect?

6 MR. BESHORE: I do not.

7 JUDGE CLIFTON: Mr. Hollon, you may step down.

8 MR. HOLLON: Thank you.

9 JUDGE CLIFTON: You're welcome.

10 MR. BESHORE: And that concludes our case-in-chief.

11 JUDGE CLIFTON: Well done, Mr. Beshore, well done. Your
12 expertise in these matters is extremely helpful.

13 Well, Mr. English, are you ready to go? Please come to
14 the podium.

15 MR. ENGLISH: Well, your Honor, actually before we are
16 ready to go, we have, in the form of a motion, this has to do
17 with not limited to, but certainly beginning with, the
18 Cooperatives' study conducted by Professors Stephenson and
19 Nicholson, and it's a motion to draw a negative inference of a
20 failure to introduce relevant evidence.

21 So let me make a predicate, and then I'm going to read
22 this in the record, but I'll pass it out and propose to make it
23 an exhibit.

24 So, your Honor, under the Administrative Procedure Act
25 5 U.S.C. Section 556, proponents of a change, or in this case,

1 the creation of a regulation, have the burden of proof and the
2 burden of going forward. In light of that, when we, on our
3 side of the aisle -- we are all sitting on the same side of the
4 aisle -- but we, those who are opponents of Proposal 1, learned
5 of the existence of the study that the Cooperatives requested
6 of Dr. Stephenson and Nicholson, Mr. Vetne requested, by
7 e-mail, a copy of that study from Mr. Beshore, by e-mail dated
8 June 17, 2015. And Mr. Beshore promptly responded no.

9 On September 15th of this year, in a joint letter on my
10 letterhead to Mr. Beshore, we again requested the report and
11 indicated that if it was not made available, we might seek to
12 invoke, at this hearing, an evidentiary presumption with
13 respect to refusal to provide that study. And we did, in short
14 form, provide some case law in that communication to
15 Mr. Beshore. Other than, of course, in this proceeding where
16 that study has not been made available, we have not heard back
17 from the Cooperatives with respect to that issue.

18 So at this time, we formally move for a negative
19 inference of failure to introduce relevant evidence, and I have
20 a memorandum to that effect. And I think it should be marked
21 as an exhibit, even as the stipulation was marked as an
22 exhibit.

23 JUDGE CLIFTON: I agree, that will be a good way to keep
24 track of it. This document will be Exhibit 78.

25 (Thereafter, Exhibit 78 was marked

1 for identification.)

2 MR. ENGLISH: What number did you give it, your Honor?

3 JUDGE CLIFTON: Exhibit 78.

4 MR. ENGLISH: So if everyone has one, I'm ready to proceed.

5 JUDGE CLIFTON: You may proceed, Mr. English.

6 MR. ENGLISH: So this is entitled, this has got the caption
7 of this proceeding, and then Clovis, California, October 19,
8 2015.

9 Memorandum on Negative Inference of Failure to
10 Introduce Relevant Evidence

11 "When a party has relevant evidence in its control
12 which it fails to produce, that failure gives rise to an
13 inference that the evidence is unfavorable to him."

14 That is from Int'l Union, United Automobile, Aerospace
15 and Agric. Implement Workers of Am. (U.A.W.) v N.L.R.B.,
16 459 F.2d 1320, 1336 (1972) citing 2 J. Wigmore, Evidence
17 Section 285 (3d ed.1940)); c.f. Elvis Mfg. Co. v. F.T.C.,
18 287 F.2d 831, 847 (9th Cir. 1961) ("An unfavorable inference
19 may result from the unexplained failure of a party to produce
20 documentary or other real evidence.").

21 "Unquestionably the failure of a defendant in a civil
22 case to testify or offer other evidence within his ability to
23 produce and which would explain or rebut a case made by the
24 other side, may, in a proper case, be considered as a
25 circumstance against him and may raise a presumption that the

1 evidence would not be favorable to his position." U.S. v.
2 Roberson, 233 F.2d 517, 519 (5th Cir. 1956); see also Paudler
3 v. Paudler, at 185 F.2d 901, 903 (5th Cir. 1950), cert. denied,
4 341 U.S. 920, 71 S.Ct. 742, 95 L.Ed. 1354 (1951) ("Respondent's
5 unexplained failure to support and substantiate its economic
6 justification for the layoffs by the production of probative
7 and material documentary records within the power of the
8 Respondent to produce, renders the purported reasons dubious
9 and also warrants drawing an inference that if such [records]
10 had been produced, they could not have been favorable to the
11 Respondent. This failure to produce such evidence 'not only
12 strengthens the probative force' of its absence, 'but of itself
13 is clothed with a certain probative force."); citing Goldberger
14 Foods, Inc. v. U.S., 23 Claims Court 295, 308 (1991), affirmed
15 960 F.2d 155 (Fed. Cir. 1992) (holding in a case against the
16 USDA that plaintiff's failure to furnish any of its primary
17 records on raw beef prices warranted a "strong adverse
18 inference" that such records would have a negative impact on
19 its case involving a mistaken bid).

20 The failure to produce relevant documents can warrant a
21 negative inference even when there is no subpoena compelling
22 production. Int'l Union, United Auto Workers, Aerospace &
23 Agreements Implement Workers of Am. (UAW) v. N.L.R.B., 459 F.2d
24 1329, 1338 (District of Columbia Circuit 1972) ("If evidence
25 within the party's control would, in fact, strengthen his case,

1 he can be expected to introduce it, even if it is not
2 subpoenaed. Conversely, if such evidence is not introduced, it
3 may be inferred that the evidence is unfavorable to the party
4 suppressing it.")

5 I'll insert here that the Cooperatives, of course, are
6 free not to produce the document. That is their right. But
7 their can be, and should be, consequences for doing so.

8 Returning to Exhibit 78. "That an inference -- that an
9 adverse inference may arise from the fact of missing evidence
10 is a generally accepted principle of law." *Smith v. United*
11 *States*, 128 F. Supp.2d 1227, 1232 (Eastern District of Arkansas
12 2000) (holding that the failure of a party to create standard
13 medical records for a patient's surgery warranted the
14 application of the negative inference).

15 As stated by Professor Wigmore, "The failure to bring
16 before the tribunal some circumstance, document or witness,
17 when either the party himself or his opponent claims the fact
18 would thereby be elucidated, serves to indicate, as the most
19 natural inference, that the party fears to do so, and this fear
20 is some evidence of the circumstance or document or witness if
21 brought, would have exposed facts unfavorable to the party."
22 2 J. Wigmore Evidence Section 285 (3d ed. 1940).

23 Thus, USDA can and should find that the study
24 proponents refused to disclose would have been adverse to their
25 affirmative claims. *Interstate Circuit v. United States*, 306

1 U.S. 208, 226 (1939); Stagner v. United States, 197 F.2d 992,
2 994 (5th Cir. 1952); and Local 167 v. United States, 291 U.S.
3 293 (1934); 29 Am. Jur. 2nd Evidence Section 178.

4 So I'll insert again, so this is not a new principle.
5 We're looking at a principle that goes way back in American
6 Jurisprudence.

7 Back to the exhibit.

8 This evidentiary rule is applicable in administrative
9 as well as judicial proceedings. Singh v. Gonzales, 491 F.3d
10 1019, 1024-25, (9th Circuit 2007); In re DeGraff Dairies,
11 41 Agric.Dec. 388, 402-403 (1982). In hearings under The
12 Administrative Procedure Act Section 556, agencies may clearly
13 "draw such inferences or presumptions as the courts customarily
14 employ, such as the failure to explain by a party in exclusive
15 possession of the facts..."

16 The Attorney General's Manual on the Administrative Procedures
17 Act (1947), at page 76.

18 The USDA has utilized such inferences before. The
19 Tenth Circuit has affirmed a United States Department of
20 Agriculture Administrative Law Judge's use of an adverse
21 inference regarding a party's failure to introduce testimony
22 evidence. See Reed v. USDA, 39 F.3d 1192, 2* (10th Cir. Nov.
23 1, 1994) (affirming a United States Department of Agriculture
24 Agriculture Law Judge's use of the inference in a cattle
25 shipping case).

1 JUDGE CLIFTON: That's Administrative Law Judge.

2 MR. ENGLISH: I'm sorry, did I not say Administrative Law
3 Judge?

4 JUDGE CLIFTON: No, you said Agriculture Law Judge, but I
5 like it.

6 MR. ENGLISH: But thank you for the correction,
7 Administrative Law Judge.

8 In another case appealed from the USDA, the Second
9 Circuit ordered the lower court to conduct further fact finding
10 on the claims involving defective potatoes in the case, an
11 assessment which it noted "may take into account any negative
12 inferences that may be drawn from G&T's failure to keep resale,
13 sorting, and dumping records." G&T Terminal Packaging Co.,
14 Inc. V. Joe Phillips, Inc., 798 F.2d 579, 581 (2nd Cir. 1986).

15 None of the limitations that apply to negative
16 inferences exist here. For example, a party may not seek to
17 employ the inference for evidence it failed to request during
18 the discovery period. See *Faucette v. National Hockey League*,
19 2006 West Law 213857 (Middle District of Florida, cited January
20 27th, 2006). No such discovery requirements apply to this
21 proceeding, and, regardless -- I'll insert here -- we made
22 constant requests. So even if discovery were sort of implied,
23 it's not like we're surprising anybody, we have made this
24 request consistently.

25 Additionally, this inference cannot be applied against

1 a defendant who asserts his Fifth Amendment rights when the
2 government seeks to prove its criminal charge based on an
3 inference that the defendant did not testify. Stone v. U.S.,
4 390 U.S. 204 (1968). Again, a circumstance that does not apply
5 here.

6 Exhibit 53, introduced during Eric Erba's testimony is
7 a transcript from a hearing before the CDFA dated May 20,
8 2013 -- was it 2013 or later? Actually, I'll stop there.

9 The subject of the hearing was: "Consolidated Public
10 Hearing to Consider Temporary Market Amendments to the
11 Stabilization and Marketing Plans for Market Milk for the
12 Northern and Southern California Marketing Areas." On page 55,
13 Mr. Erba says the following about the study that Proponent
14 Cooperatives have otherwise failed to introduce:

15 "I will make one final point in support of
16 California Dairies' proposal. Recently,
17 California Dairies received the results of a study
18 that reviewed the potential impacts of a Federal
19 Milk Marketing Order in California. We, along
20 with the -- I think the transcript says "Diary" --
21 so [Dairy] Farmers of America and Land O'Lakes
22 co-funded the study conducted by Drs. Mark
23 Stephenson and Chuck Nicholson. The study
24 identified the large Class 4b-Class III, price
25 spread as being problematic and suggested that a
manufacturing differential on the Class III price
could resolve the problem of higher milk prices
while simultaneously encouraging pool
participation by cheese plants. The level of the
differential is about \$.70 cents per
hundredweight. In other words, the study
suggested that the California price for milk used
for cheese ought to be \$.70 cents less than the
Federal price. That \$.70 cent differential is
approximately the same as what was represented in

1 hundredweight increase in the Class 4b price that
2 we are proposing today."

3 This one statement by itself reveals that the
4 undisclosed study contains economic analysis of price surface
5 issues that contradict some of witnesses assertions that milk
6 used to produce manufactured products does not have location
7 value. One or more Cooperative witnesses denied knowledge of
8 any model regarding price surface issues that is more current
9 than that used in FMMO reform -- they did acknowledge the
10 existence of the study, of course -- I inserted that. If
11 Proponents still refuse to produce the study, the negative
12 inference that should be drawn is the remainder of the study
13 undermines Proposal 1.

14 I think Mr. Vetne was going to supplement? Or not?

15 JUDGE CLIFTON: Let's find out. Do you, Mr. English, have
16 anything to add?

17 MR. ENGLISH: Not at this time.

18 JUDGE CLIFTON: All right. And, of course, I want to hear
19 from all of you about this extraordinary motion, extraordinary
20 in that most of the citations don't have anything to do with
21 what we're doing here, but I don't know in what order you want
22 to proceed.

23 MR. ENGLISH: Well, may I respond to that, your Honor?

24 JUDGE CLIFTON: Not yet. I'll go last and then you may
25 respond to all of it. So in what order do you want to proceed,

1 and do you want to do it now? Mr. Vetne does. Mr. Vetne, you
2 may proceed

3 MR. BESHORE: May I?

4 JUDGE CLIFTON: Mr. Beshore?

5 MR. BESHORE: Before Mr. Vetne proceeds, I would object to
6 any non-attorneys arguing legal motions.

7 JUDGE CLIFTON: No, no, no, well, your objection is noted.
8 Mr. Vetne may no longer be legally an attorney because he's
9 retired, he's a representative. But I'll certainly hear any
10 contribution he has with regard to the law. I respect his
11 opinion highly and I have already accepted his opinion on legal
12 matters throughout this proceeding and found them quite
13 helpful.

14 So, Mr. Vetne, you may come forward. We're all
15 struggling with the law here. We're all trying to deal with
16 it, lawyers and non-lawyers alike.

17 MR. VETNE: John Vetne for Hilmar Cheese.

18 I just wanted to expand on this slightly. As
19 Mr. English noted, and as I have been using for about 40 years,
20 we come to this hearing because it's a formal proceeding
21 covered by Section 556 and 557 of the APA.

22 556 says that the proponent of a rule has a burden of
23 proof, and the decision will be based on the substantial record
24 evidence. That's a starting point. And then we get to the
25 Agricultural Marketing Agreement Act. And you know, here are

1 the he elements to consider, here's our policy from the past,
2 and so forth. So that's the starting point. But we have heard
3 from the very beginning of this proceeding that the problem
4 here in California, why we want a Federal Order, is the cheese
5 is underpriced. The value of milk used to produce cheese is
6 underpriced in California and it ought to be higher. And in a
7 Federal Order Reform Decision, USDA said, the importance of a
8 surplus milk price that is market clear and cannot be
9 understated, that's almost a direct quote, but I'm doing it by
10 memory. And that is a price that is for milk charged to the
11 manufacturer that receives milk, billed in a margin of what it
12 costs to make and market, that's the make allowance, and
13 account for the difference.

14 If either the price that can be obtained from sale of
15 the commodity or the margin make allowance are erroneous, then
16 there is no margin, there is no return on investment, there is
17 no ability to make cheese.

18 So one thing that I had expected and hoped to find from
19 Proponents during the presentation of their case is some
20 evidence on the price that the Cooperative Proponents have,
21 over the years, been able to receive for the products they make
22 and market nationally so that USDA can be assured that if we
23 fix a price that's essentially set elsewhere, that they will
24 receive a return on investment. That is the process that for
25 probably a century has been applied in every kind of rate

1 making proceeding. The average utility cost a couple of years
2 ago was twelve cents per kilowatt hour, and if regulators were
3 to take the average and apply it to the individual circumstance
4 where the power generator could not recover a return on
5 investment at twelve cents, it would be unreasonable. It would
6 be confiscatory. And that is really the focus of the issue in
7 this proceeding.

8 So I agree with the negative inference that on a
9 substantial record evidence basis, the absence of any product
10 price revenue, product price received, product price ability to
11 gain from the market as a starting point upon which to build
12 make allowances. If this were a court proceeding, this would
13 be the time when I used to make a motion for directed verdict.

14 Plaintiffs have not proven their case. We come to this
15 point. Proponent's are done, it hasn't been made, our
16 proceeding is that we go forward and proponents might have a
17 chance to come back. But I think the inference goes broader
18 than just the Stephenson-Nicholson study. Thank you.

19 JUDGE CLIFTON: Well, don't leave yet, I have a couple of
20 questions for you. Is there a nationwide market for
21 manufactured products?

22 MR. VETNE: Yes, there is.

23 JUDGE CLIFTON: All right. Then let me ask you, is that
24 based on a return on investment or is there some other standard
25 for it?

1 MR. VETNE: For the cheese market?

2 JUDGE CLIFTON: For manufactured products.

3 MR. VETNE: The cheese clears nationally. There is a price
4 each month that's determined nationally, and that price is the
5 combination of transactions from cheese makers to that market.
6 The question is not whether the cheese market clears
7 nationally, it is whether the milk market can clear locally. A
8 national clearing price for cheese is not the same as a local
9 clearing price for milk. That's the issue.

10 JUDGE CLIFTON: Thank you.

11 MR. VETNE: Thank you.

12 JUDGE CLIFTON: Mr. Beshore, do you want to talk now or do
13 you want to take a break?

14 MR. BESHORE: I would like to talk now.

15 JUDGE CLIFTON: You may.

16 MR. BESHORE: And Marvin Beshore -- and I will just talk
17 briefly. I would reserve the -- we'll brief this. We'll brief
18 this legal issue, and I would like to reserve the right to read
19 my brief into the record sometime later in this hearing if we
20 choose to do that, of course we may just brief it at
21 post-hearing.

22 JUDGE CLIFTON: Well, wait a minute, I got to decide,
23 don't I?

24 MR. BESHORE: When -- at some point. You don't have to
25 decide this.

1 JUDGE CLIFTON: So you believe this motion is not for me to
2 weigh in on at all, but strictly for the Agricultural Marketing
3 Service to take under consideration.

4 MR. BESHORE: Absolutely, I just heard them argue -- argue
5 their case, on the, you know, what the evidence shows, and what
6 it doesn't show, and what it should show, and what it shouldn't
7 show. This is the weighing.

8 JUDGE CLIFTON: You don't think that I'm supposed to weigh
9 in on this prior to the end of the hearing so that you have a
10 second chance to decide whether to produce the study?

11 MR. BESHORE: Well, I think, you know, we can choose to
12 produce the study any day from, you know, from now to the rest
13 of the hearing if we choose to.

14 JUDGE CLIFTON: I know that.

15 MR. BESHORE: So that -- but I don't -- in terms of, is
16 this something that under the rules of practice calls for a
17 ruling from your Honor as the presiding Administrative Law
18 Judge in this hearing?

19 JUDGE CLIFTON: That's a very good question.

20 MR. BESHORE: Okay. So I don't think it does. Because
21 it -- it's just -- it's directed to the decision-making
22 process. Which as you've noted at the beginning of everyday of
23 the hearing, is not vested in your chair, but in other chairs.
24 And that's -- this is all just, you know, addressed to the
25 decision-making process, and what, you know, what inferences

1 should be involved in that process. So I would request, I
2 would suggest, I would request that, you know, if we decide to
3 brief, to submit a brief on this issue as an exhibit in this
4 hearing, that, you know, I may request the right to read it
5 into the record and present it at that time, as has been done
6 by Mr. English and most of the arguments by Mr. Vetne.

7 With that said, I have got just a couple of comments at
8 this point that I would like to make. Okay.

9 First of all, as your Honor has noted, there are
10 treatises and treatises on the Rules of Evidence that are not
11 applicable to these proceedings, Rules of Legal Evidence. They
12 are applicable in district courts, and jury trials, etcetera,
13 etcetera, that are applicable to this proceeding. I mean, this
14 is just one, you know, one part of those Wigmore-Horn books and
15 treatises on evidence. Federal Rules of Evidence, as has been
16 said earlier, do not apply to these proceedings and lots of
17 common law, I venture, the presumptions do not apply.

18 None of these cases is a Rule 556 rule making hearing.
19 Okay? None of them. We haven't found any. The Attorney
20 General, closest thing there is the Attorney General's '47
21 memorandum on what the Administrative Procedure Act, when it
22 was just passed, there was a memorandum and there's an
23 observation in there. You know, that may or may not relate to
24 this particular inference. In any event, there aren't any rule
25 making cases for this principal that's ever been applied. And

1 the closest case actually is this, which isn't really close
2 exactly, but the DeGraff Dairies case, of course involved the
3 regulated milk order in a 1580 proceeding. In a 1508
4 proceedings, not a rule making proceeding. Which is an
5 adjudicatory proceeding where facts specifically related to
6 individual parties are what determine the case. This is rule
7 making. It is general rules to all parties.

8 And I would just make two other quick comments. One,
9 if Mr. Vetne has the courage of his convictions, and that would
10 apply to Mr. English, too, that there hasn't been enough
11 evidence presented to support the rule, I think they should
12 rest and not present any evidence in this proceeding. We'll
13 see if they have the courage of their convictions.

14 And beyond that, I would, you know, I would only say
15 that if this negative inference were to apply to the
16 Stephenson-Nicholson report, then I would also suggest that it
17 will apply to every P and L, internal profitability analysis,
18 etcetera, of every member of the Dairy Institute and every
19 other party that will object and oppose Proposal 1. If they
20 don't produce all of those records, then the inference should
21 be that those records would all "that a negative inference
22 should be drawn with respect to their position on Proposal 1."
23 So if we don't see internal profitability studies with respect
24 to all of the California plants involved in opposing this, and
25 Hilmar, etcetera, etcetera, then the negative inference will be

1 that those financial records would not support their opposition
2 to Proposal 1. Thank you.

3 JUDGE CLIFTON: Mr. English, would you come back to the
4 podium? I like best of all Mr. Beshore's suggestion that I
5 need not rule. Do you agree with him?

6 MR. ENGLISH: I -- let me say yes and maybe.

7 And I mean, I think obviously the issue needs to be
8 briefed. I would stress that it's not like we came here with a
9 surprise. And Mr. Beshore could have, and I believe should
10 have, been prepared for our doing exactly what we're doing. We
11 warned him in advance, cautioned him. We gave him some of our
12 legal analysis back over a month ago. And I think your Honor
13 could rule. But I think that it could also take his time. I'm
14 not saying that you shouldn't rule on it at the conclusion of
15 the hearing because of the way motions work on part 900 and our
16 ability then to appeal the Secretary. So I think actually
17 there's a question of whether you need to rule at some time,
18 but I'm not going to insist that you rule now.

19 I do take issue with the idea that somehow this is
20 different. This is a proceeding unlike any other kind of rule
21 making, given the nature of this being taken under oath with
22 your Honor as the Law Judge, and I think that that under
23 5 U.S.C. 556, and this distinguishes us, they are the
24 proponents, they have to prove the need for an order. We don't
25 have to prove anything.

1 And it's also different in that we have seen pieces of
2 the study made public, and then pieces of it kept confidential.
3 That's different from the P and L's that the attorney for CDFA
4 recognized would be subject to trade secret information, which
5 is the different concept.

6 And, finally, you know, it's one thing to talk about
7 courage of conviction, it is another thing to talk about micro
8 malpractice laws with respect to whether or not I can sit down.
9 Mr. Vetne suggested, and we seriously considered, making a much
10 more lengthy presentation today that is in the form of a motion
11 to close this proceeding. That would be, I recognize, a waste
12 of time. So we're going to go forward, but we do think that
13 this is an important motion, and it does need to be examined,
14 and it is of critical importance that this particular study,
15 which the Cooperatives relied on for asking for the hearing,
16 not be withheld from the record.

17 JUDGE CLIFTON: Don't leave yet. Had you come to a
18 stopping point?

19 MR. ENGLISH: Yes, I have come to a stopping point and
20 needed water.

21 JUDGE CLIFTON: All right. I won't rule today. I probably
22 won't rule the rest of the this hearing. I'll probably leave
23 it to the Agricultural Marketing Service to rule. But I have a
24 question for you, Mr. English, the method of producing evidence
25 at a hearing is to have a witness, a live witness come to

1 testify and be available for cross-examination. Are you
2 suggesting some sort of a stipulation by which the study would
3 be made available in this hearing without any supporting
4 identification and cross-examination available for by the
5 authors?

6 MR. ENGLISH: Your Honor, may I get my laptop?

7 JUDGE CLIFTON: Yes.

8 MR. ENGLISH: The short answer is, you don't need that. We
9 have had on the stand, economic experts, who, pursuant to the
10 Federal Rules of Evidence, which are more strict than the ones
11 here, this goes back to Mr. Vetne's point, that the real point
12 of qualifying a person as an expert isn't so they can be given
13 greater weight, but they can opine on other learned treatises
14 or studies. We do not need Professor Stephenson or Professor
15 Nicholson to appear in order for the co-ops to say yes, we
16 received this, this is the study, and this is what it shows,
17 and my professional opinion is X and then Dr. Schiek can say my
18 professional opinion is Y. That is the point, going back to
19 Mr. Vetne's point two weeks ago, of why we actually qualify
20 experts. It is so they can, under the Federal Rules of
21 Evidence 80318, actually opine, and therefore, the study is not
22 hearsay. We have had plenty of that.

23 JUDGE CLIFTON: It's true. I agree with you. I hadn't
24 thought of it, but I agree with you. Do you want to add
25 anything more?

1 MR. ENGLISH: Not at this time, your Honor.

2 JUDGE CLIFTON: All right. So Mr. Beshore, it's in your
3 court as to how you want to handle it. If you want to wait to
4 brief this when you have gone back to your office after all of
5 the evidence has been taken, I think that's fine. Because I
6 believe this should be decided, not by me, but by the decider
7 of fact, which is the Agricultural Marketing Service. So they
8 have good lawyers and they can decide whether any negative
9 inference should be drawn. So I guess I have said what I need
10 to say. Anything further on this issue, Mr. English?

11 MR. ENGLISH: No, your Honor. Thank you.

12 JUDGE CLIFTON: And does anyone else want to be heard on
13 this issue or to ask questions right now of any of the three
14 who have talked about it? You don't have to ask questions.

15 MR. ENGLISH: Like appellate judges? Appellate judge
16 panel?

17 JUDGE CLIFTON: No, just inquisitive minds want to know.
18 All right. Not at this time. Now, that does not mean that
19 shouldn't be asked and could be asked later.

20 MR. ENGLISH: I'll be here for a few weeks, your Honor.

21 JUDGE CLIFTON: All right. That having been said, we'll
22 move on. We have identified Exhibit 78, because it's a motion,
23 we won't be putting it into evidence, but it will be part of
24 those exhibits that are identified.

25 Now, what would you like to do next, Mr. English?

1 MR. ENGLISH: Well, I guess I would like to consult with
2 Dr. Schiek. Dr. Schiek suggests lunch, but I do have maybe A
3 housekeeping thing we can do before lunch.

4 And I caution that this is subject to some revision,
5 but Mr. Richmond asked the question of the Cooperatives after
6 Mr. Hollon was done, of basically a roadmap.

7 And while I have a number of moving pieces, I would
8 like to provide a roadmap, and I need my computer because I
9 need to bring up the Department of Agriculture's suggested
10 topics so I get them correctly.

11 And given the fact that obviously we're now, I guess,
12 technically finishing week four, because we started on Tuesday,
13 but I would call this week five.

14 JUDGE CLIFTON: No, I agree with you. We'll keep track of
15 days and we'll keep track of weeks. Today begins week five.
16 In light of that, mine is not going to flow as Mr. Beshore's
17 did, from point to point. We are going to have, as I think I
18 suggested last week, some witnesses coming in this week who
19 wouldn't fit in this natural order. But nonetheless, I'm going
20 to give the natural order, and then we'll have to deviate from
21 it as witnesses are available.

22 Going to the issue of opening statements,
23 justification, scope and purpose, which is topic one on USDA's
24 suggested topics. We will obviously have Dr. Schiek this
25 afternoon.

1 After Dr. Schiek, but again, probably interrupted by
2 some things we'll talk about in a moment, I expect at least
3 five other witnesses, two of whom would be fluid milk
4 processor, will be considered distributing plants, and three
5 that are cheese makers.

6 Going to Issue 2, Definition and Pooling Standards.
7 Now I note, as I did in my opening statement, that there are a
8 number of areas where we're not going to have disagreement, so
9 not all of these issues will be discussed, and I'll take some
10 of these out of order. So for instance, quota and
11 producer-handler will be taken later, but otherwise,
12 definitions and pooling standards we expect, leaving out the
13 producer-handler and quota issues, approximately four to five
14 witnesses.

15 Turning to Issues 3 and 4, which I think we really have
16 very little disagreement with the Cooperatives, I think we
17 might have one witness and maybe some others will touch on some
18 of the issues, but one witness on 3 and 4 and it may be very
19 short.

20 JUDGE CLIFTON: Tell us again what 3 and 4 are.

21 MR. ENGLISH: I'm sorry, I apologize. That's why I brought
22 my computer up. Number 3 was the Rules of Practice and
23 Procedures Governing Market Administrators and Order
24 Provisions; and number 4 was Rules of Practice and Procedure
25 Governing Handlers. So handler's responsibility for records

1 and facilities and termination of obligations and other
2 reports. And I think we're looking primarily at producer
3 report kind of issues and reports for receipts of utilization.

4 JUDGE CLIFTON: Reports of what?

5 MR. ENGLISH: Utilization -- receipts and utilization.

6 Turning to Issue 5, Classification of Milk. I think
7 that primarily issue we will face there is the treatment of
8 shrinkage on extended shelf life processing lines. And for
9 that, I believe we have four to five witnesses, and those would
10 be starting probably tomorrow afternoon. I'm not sure which of
11 these two is going to come first. Obviously, they relate to
12 each other, but when you get to Issue 6, Class Prices, we would
13 expect six to eight witnesses with respect to Class Prices.

14 Picking up on Number 2, Quota, which I said will not be
15 taken in that order, that would be taken probably after pricing
16 or during pricing in some way. We expect six to eight
17 witnesses with respect to quota.

18 As to Market-Wide Surface Payments, Number 7, we would
19 expect two to three witnesses.

20 I think Producer Prices and Payments for Milk will
21 probably would be merged with class prices, Number 6, and quota
22 issues. That's number 8, by the way.

23 JUDGE CLIFTON: If you don't mind, what I'm going to ask
24 you to do is, each morning I'm going to ask you again to give
25 me the portion of the roadmap that we are going to be entering

1 in the near future, but this is extremely helpful to have this.

2 MR. ENGLISH: Thank you.

3 JUDGE CLIFTON: And I am glad to have it.

4 MR. ENGLISH: And I will do my best each morning to have it
5 accurate. As I say, I think there are some moving pieces here,
6 people coming in, but yes, I will try to do that, your Honor,
7 we'll do that during the preliminary section.

8 With respect to Number 9, Administrative Assessment
9 Marketing Service Deduction and Miscellaneous Provisions, I
10 expect one, maybe two, witnesses. Then having taken
11 producer-handler in Section 76 out of order, I expect two to
12 three witnesses.

13 And then finally, even though there's going to be
14 witnesses who come in, who are say a small cheese plant
15 operator or something, so I would call them general witnesses,
16 and I think we have something north of five of those.

17 JUDGE CLIFTON: And I would like someone from Agricultural
18 Marketing Service to make sure that the court reporter takes
19 home a copy of that proposed agenda. It will be easier to type
20 what Mr. English just identified with a copy of the of those
21 words.

22 MR. ENGLISH: Could I have a copy, too.

23 JUDGE CLIFTON: Did we run out?

24 MR. ENGLISH: Oh, I'm sorry, this is the topic list. I
25 thought you meant what I just said. I would love to see it.

1 But that's what I think we have. I think this week we'll spend
2 most of the time on that item one, opening statements, and the
3 ESL sheet.

4 JUDGE CLIFTON: Who has questions for Mr. English about the
5 roadmap? Mr. Miltner?

6 MR. MILTNER: Ryan Miltner.

7 My question is, as I count 35 to 45 witnesses or so,
8 and my curiosity is, are those each individuals or does that
9 include people who may appear multiple times?

10 MR. ENGLISH: It includes people who will appear multiple
11 times. Dr. Schiek will likely testify four or five times, he's
12 greatly appreciative of that.

13 I think it's safe to say that especially the people who
14 are appearing in item one, will likely be heard from again.
15 But those are clearly overlap. I think also, it is safe to say
16 that some of these will be very short. And by the way, these
17 do not include Mr. Vetne's witnesses that he talked about last
18 Friday. This is, these are strictly Dairy Institute of
19 California witnesses.

20 JUDGE CLIFTON: Mr. Beshore?

21 MR. BESHORE: Did I understand this week you figure, are
22 the witnesses on topic one plus ESL?

23 MR. ENGLISH: Yes.

24 MR. BESHORE: Thank you.

25 MR. ENGLISH: That is our intent. I cannot promise

1 someone's not going to show up on Wednesday that I wasn't
2 expecting.

3 JUDGE CLIFTON: Mr. English, if you would go back to the
4 podium.

5 MR. ENGLISH: Yes, your Honor.

6 JUDGE CLIFTON: I believe you are not only a proponent, but
7 you also represent opposition to Proposal Number 1; is that
8 correct?

9 MR. ENGLISH: I have thought about every morning when we
10 are introducing ourselves, to say that we are opponents of
11 Proposal Number 1, and if there's to be an Order, then we're
12 proponents of Proposal 2. But yes, we are, these witnesses
13 will be testifying in opposition to Proposal 1.

14 JUDGE CLIFTON: And that will be all fused together?

15 MR. ENGLISH: Yes. We're not going to have, after I'm done
16 with that, our opposition to 1 is done, our support of 2 is
17 done, it's an alternative to 1, and we will have discussed
18 exempt quota to the extent we intend to address exempt quota.

19 JUDGE CLIFTON: Does anyone else have any further questions
20 of --

21 MR. ENGLISH: With one caveat. Since we haven't seen the
22 language that's proposed, we may have to come back after the
23 language is proposed, if it has not yet been proposed by the
24 time we are done.

25 JUDGE CLIFTON: Does anyone else have any questions of

1 Mr. English? Of course, you can -- you can ask questions each
2 morning when he identifies the segment that we're about to go
3 into. All right. Thank you, Mr. English.

4 MR. ENGLISH: Thank you, your Honor. I propose lunch.

5 JUDGE CLIFTON: Very good. I agree with you, this is a
6 good time to break. It is now 12:15. Please be back and ready
7 to go at 1:30.

8 (Whereupon, the lunch recess was taken.)

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1 MONDAY, OCTOBER 19, 2015 - - AFTERNOON SESSION

2 JUDGE CLIFTON: We're back on record at 1:34. Is there
3 anything preliminary to our taking testimony of Dr. Schiek? It
4 appears not. We do have some exhibits to distribute.

5 MR. ENGLISH: Yes, your Honor. I have already given to
6 USDA, Pam's got three copies of each, there's the testimony of
7 Dr. William Schiek, Part 1, and Exhibits, figures and tables
8 for the testimony of Dr. William Schiek. And I also provided
9 your Honor a copy and the court reporter a copy.

10 JUDGE CLIFTON: Excellent. So would you like the testimony
11 to be the first number?

12 MR. ENGLISH: Yes, I would like testimony I believe to be
13 Exhibit 79.

14 JUDGE CLIFTON: Yes, that will be good. And then the
15 figures and tables will be 80.

16 (Thereafter, Exhibit 79 and Exhibit 80 were
17 marked for identification.)

18 JUDGE CLIFTON: If you did not yet get a copy of Exhibit 79
19 and 80 and want one, would you please raise your hand. Raise
20 your hands again so Ms. Vulin can see them. She's going to
21 make copies and bring them to you.

22 All right. Then, shall we go forward, Mr. English?

23 MR. ENGLISH: Yes, your Honor.

24 JUDGE CLIFTON: All right. Then, Dr. Schiek you may be
25 seated in the witness stand. Dr. Schiek I know this is Week 5,

1 is this the first time you have testified in this proceeding?

2 DR. SCHIEK: It is.

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

4 Do you solemnly answer or affirm under penalty of perjury
5 that the evidence you will present will be the truth?

6 DR. SCHIEK: I do.

7 JUDGE CLIFTON: Please state and spell your name.

8 DR. SCHIEK: My name is William, W-I-L-L-I-A-M, Schiek,
9 S-C-H-I-E-K.

10 JUDGE CLIFTON: Thank you. Mr. English, you may proceed.

11 MR. ENGLISH: Thank you.

12 Your Honor, as we begin with Exhibits 79 and 80, I want
13 to note four or five things.

14 First, instead of footnotes we have endnotes that
15 appear on page 40. They are all strictly pure references, as
16 opposed to text that would be attritional footnote. And I
17 would ask that rather than having them read into the record,
18 they simply appear in the transcript as stated in Exhibit 79,
19 and that the witness not have to note where they appear. The
20 court reporter can take care of that as going along. But
21 rather than interrupt the flow with footnotes that are
22 genuinely citations to materials upon which the Dr. Schiek
23 relies, that they be treated as if read, to prevent tedium of
24 reading those in.

25 JUDGE CLIFTON: All right. I would like to address an

1 issue now about that. I think testimony does not have to
2 conform identically to the exhibit. And I don't want to put
3 added burden on the court reporter. So I want to go off record
4 and determine whether this kind of thing does, in fact, present
5 added burden. We know we're not going to use tables. I think
6 normally just typing text is a whole different thing, but when
7 it is formatted as footnotes that doesn't line up with the way
8 the transcript lines go, which I think is like 25 lines per
9 page, so I want to go off record, and if this is going to
10 present any burden in the preparation of the transcript, I
11 don't want us to do it that way because --

12 MR. ENGLISH: I understand, your Honor, I get that. If,
13 you know what, the exhibit is going to be admitted presumably
14 and therefore, references will be there.

15 JUDGE CLIFTON: Is it fine with you?

16 MR. ENGLISH: Yes.

17 JUDGE CLIFTON: Bless you. Thank you. We will not even
18 have to go off record. Thank you, Mr. English, I really
19 appreciate that.

20 MR. ENGLISH: That's point 1.

21 JUDGE CLIFTON: Okay.

22 MR. ENGLISH: Point 2, Dr. Schiek and I --

23 JUDGE CLIFTON: No volume.

24 MR. ENGLISH: Dr. Schiek and I have a slightly different
25 version which is for readability purposes of the document for

1 readability purposes. So if at some point there is a
2 correction, which I know we'll be making, I will have the
3 version you have so I can, and he does, too, so we can make
4 sure we are looking in the same place. And that also is for
5 cross-examination when somebody says look at page 12, he needs
6 to have that version in front of him.

7 Third, related to that, periodically I will actually be
8 asking Dr. Schiek to stop and I'm going to ask him several
9 questions, and then pick back up in the testimony and obviously
10 I will make it clear where we are as we go forward.

11 Next, because part one is primarily about history of
12 California, unless Dr. Schiek says otherwise, all class numbers
13 will be Arabic rather than Roman. So rather than having the
14 witness have to say "Arabic 4" unless he says "Roman" then it
15 is taken as Arabic.

16 And finally, Mr. Beshore will be pleased to know that
17 some of his Gremlins have migrated over to us, and we know we
18 have some fixes. We were working on his testimony early this
19 morning, late last night, and then we wanted to copy it and
20 have it ready to go. So we're aware there's going to be some
21 things to be fixed as we go forward.

22 And with that, Dr. Schiek, could you begin with your
23 statement, which is Exhibit 79, identified as Exhibit 79?

24 JUDGE CLIFTON: Before you do that, you, again, have been
25 very skimpy on your --

1 MR. ENGLISH: We're going to take care of that, your Honor.
2 That was one of my periodic interruptions. You are ahead of
3 me.

4 JUDGE CLIFTON: Good. Thank you. Then you may begin.

5 DR. SCHIEK: Thank you, your Honor.

6 DIRECT EXAMINATION

7 BY DR. SCHIEK:

8 INTRODUCTION

9 My name is William Schiek, S-C-H-I-E-K. For the past
10 18 years I have been Economist for Dairy Institute of
11 California, a trade association representing fluid milk
12 processors and dairy product manufacturers with the plants in
13 California. Dairy Institute's offices are located at 1127 11th
14 Street, Suite 718, in Sacramento, California. Our organization
15 has been representing California milk processors since 1939.

16 Today, Dairy Institute represents 25 dairy companies
17 which process approximately 65 percent of the state's fluid
18 milk and manufacture about 90 percent of the state's cheese,
19 and 75 percent of its cultured dairy products and ice cream.
20 Dairy Institute's members operate in both state marketing areas
21 in California. Dairy Institute provides member companies with
22 market and regulatory information services, and advises them on
23 regulatory and legislative issues impacting their business
24 operations. We also serve as our members' primary advocate on
25 dairy legislative and regulatory matters.

1 BY MR. ENGLISH:

2 Q. Thank you. So this is where I was going to do some
3 additional discussion of who Dr. Schiek is, your Honor.

4 So prior to your joining Dairy Institute staff, what
5 were you doing?

6 A. I was Assistant Professor of Agricultural Economics at
7 Purdue University in West Lafayette, Indiana, and that was from
8 1991 through 1997.

9 Q. And what were your responsibilities when you were at
10 Purdue?

11 A. Yeah, at Purdue I had the responsibility for teaching
12 courses in Agricultural Marketing and Food Business Management.
13 I conducted research on a variety of food and agricultural
14 marketing topics, including dairy marketing topics.

15 Q. So before that, what did you do?

16 A. Before that, I was employed by the New York-New Jersey
17 Milk Market Administrator's Office, that was old Federal Order
18 Number 2. Those of you who know Eric Rasmussen, he was the guy
19 who hired me. And I did that right out of college. I was
20 working there as a Cooperative Relations Specialist from 1982
21 to 1984, and then as an Economist from 1985 to 1989.

22 Q. So you mentioned college, so what was your
23 undergraduate degree in?

24 A. My undergraduate degree was a Bachelor of Science in
25 1982 that I got at Cornell University in Ithaca, New York.

1 While I was there, actually, that was sort of my start in the
2 whole great world of dairy marketing. Dr. Erba knows this
3 history. I started working on a study of milk hauling costs in
4 New York as a summer job, working with my major professor, and
5 that sort of introduced me to a lot of the players in the
6 industry in New York, as well as the Market Administrator. So
7 a couple years later they hired me.

8 Q. And what was your Bachelor of Science in from Cornell?

9 A. Yeah, the title of the degree was Applied Economics and
10 Business Management, which is actually kind of a business,
11 undergraduate business degree. And I believe that department
12 still offers that degree, they kind of actually specialize in
13 that now. But, you know, I took a lot of agriculture marketing
14 policy courses and food marketing courses as part of that
15 degree.

16 Q. And then what did you do next for your education?

17 A. So while I was still working for the Market
18 Administrator, I began a graduate program at the University of
19 Florida in Gainesville, Florida -- and you have got a few alums
20 here of that fine institution. So I began to pursue a Master's
21 of Science degree, and working with my major professor,
22 Dr. Emerson Babb, who some of you are familiar with, who spent
23 a lot of years working on Dairy Marketing topics and published
24 quite a bit in that area. And so I worked for my Master's
25 program, the topic of my thesis had to do with the impact of

1 reverse osmosis concentrations of fluid milk on milk markets in
2 Florida and the Southeast.

3 Q. So when did you get your Master's of Science?

4 A. So, yes, I completed that degree in 1988.

5 Q. And since --

6 JUDGE CLIFTON: May I interrupt? Do you where you are?

7 MR. ENGLISH: Yes, I do.

8 JUDGE CLIFTON: Okay. Dr. Emerson who?

9 DR. SCHIEK: B-a-b-b.

10 JUDGE CLIFTON: And Erik Rasmussen's name is spelled how?

11 DR. SCHIEK: Okay. Is anybody in the Dairy Division want
12 to give me a hand with that?

13 JUDGE CLIFTON: I know him and I know his name, I don't
14 know how to spell it.

15 DR. SCHIEK: Mr. Vetne, you must be able.

16 MR. RICHMOND: Bill Richmond, USDA. I believe it is
17 R-A-S-M-U-S-S-E-N.

18 JUDGE CLIFTON: And Erik?

19 MR. RICHMOND: Erik with a "K".

20 MR. ENGLISH: Unlike Dr. Erba, who I incorrectly in the
21 memorandum called Eric with a "K" it was, and Dr. Erba is Eric
22 with a C.

23 JUDGE CLIFTON: All right. And Erik Rasmussen with a K.
24 Thank you all.

25 DR. SCHIEK: And please don't tell him that I couldn't

1 remember how to spell his name.

2 JUDGE CLIFTON: Well, he probably knew.

3 MR. ENGLISH: He's already listening.

4 JUDGE CLIFTON: Mr. English, you may pick up where you
5 were.

6 MR. ENGLISH: Thank you very much, your Honor, and I
7 appreciate your assistance on that.

8 BY MR. ENGLISH:

9 Q. So after you got your Master's of Science, what did you
10 do next for your education?

11 A. Okay. So still at the University of Florida, I
12 continued on and pursued a Ph.D., again, working on a dairy
13 marketing topic. The title of my dissertation was the -- what
14 was it? Factors Affecting the Regional Structure of U.S. Milk
15 Production. And fortunately, that work was selected by the
16 American Association of Agricultural Economics for Honorable
17 Mention in their dissertation contest.

18 Q. And you got your Ph.D. in what year?

19 A. That would have been 1991.

20 Q. Anything else you would like to add, well, actually,
21 let me ask more questions, I apologize.

22 A. Sure.

23 Q. And in your time, you said 18 years at the Dairy
24 Institute of California, have you testified at any CDFA
25 hearings?

1 A. Many.

2 Q. Have you lost count?

3 A. I have lost count.

4 Q. I remember you testified at least at one Federal Order
5 Hearing, correct?

6 A. Yes. Actually. I believe I testified at two. There
7 was one in the spring of 2000, that was mandated hearing, I
8 believe on manufacturing costs and the Class III and IV
9 formulas.

10 Q. So you testified first at that hearing and then you
11 later testified -- I wasn't aware, I had forgotten, so I
12 apologize -- so you testified at that hearing in 2000, and then
13 you testified at the National Producer-Handler Hearing in 2009?

14 A. '09, yes, I did.

15 Q. Okay.

16 JUDGE CLIFTON: So contrary to earlier instructions, those
17 were Roman numerals, Class III and IV?

18 MR. ENGLISH: That was straying from the original
19 statement.

20 DR. SCHIEK: We're off the text here, but yeah, Roman
21 numeral Class III, Roman numeral Class IV.

22 MR. ENGLISH: Your Honor, I would move Dr. Schiek be
23 accepted as an expert in agricultural economics and airy
24 marketing and policy.

25 JUDGE CLIFTON: Would anyone like to ask questions of

1 Dr. Schiek before determining whether you have any objection?
2 There is no one. Is there any objection to my accepting
3 Dr. Schiek as an expert in agricultural economics and dairy
4 marketing and policy? There are no objections. I do accept
5 Dr. Schiek as an expert in agricultural economics and dairy
6 marketing and policy.

7 BY MR. ENGLISH:

8 Q. Dr. Schiek, would you then continue with your statement
9 with the heading Roman numeral I?

10 A. I. CALIFORNIA HAS MANAGED ITS DAIRY PROGRAMS TO KEEP
11 MARKETING CONDITIONS ORDERLY.

12 The Dairy Institute concludes that there are no
13 significant disorderly marketing conditions that would warrant
14 the promulgation of the California Federal Milk Marketing
15 Order. ("FMMO"). In the letter accompanying the submission of
16 their proposal, (Proposal 1) --

17 Q. I think you can dispense with the parens?

18 A. Okay.

19 Q. Per earlier.

20 A. The three cooperatives, Dairy Farmers of America,
21 (DFA), Land O'Lakes, Inc's, or (LOL), and California Dairies,
22 Inc., or (CDI), argue that the mere existence of differences
23 between regulated minimum prices under California State Order
24 and those in Federal Milk Marketing Orders (FMMO's) is prima
25 facie evidence of disorderly marketing. In their letter

1 justifying the need for an FMMO in California, they offered no
2 description of existing marketing conditions in the state that
3 were disorderly, only the unsubstantiated presumption that
4 different regulated price levels mean that marketing conditions
5 must be disorderly.

6 What is perhaps unusual, is that this proceeding does
7 not involve promulgating a Marketing Order in an area that is
8 presently devoid of milk pricing regulations, but in an area
9 that has a functioning and effective State Milk Marketing
10 Order. Furthermore, it is a State Order with both classified
11 pricing and market-wide pooling, two key features of Federal
12 Orders that are acknowledged to be the foundation of the policy
13 toolkit used by USDA to bring about orderly marketing in FMMO's.
14 Beyond that, California's State Order is one with a long
15 history of promoting orderly marketing and of adapting
16 regulation to changing market conditions to insure that orderly
17 marketing of milk is maintained. Indeed, California statutes
18 require orderly marketing of milk as a fundamental goal and
19 purpose of state milk price regulation

20 Q. If you can stop there for a moment. With respect to
21 that last paragraph, there's been other testimony in this
22 hearing about what happened in North and South Carolina that
23 led to a promulgation of orders in those areas where there was
24 state regulation. What can you say about what happened in the
25 Carolinas?

1 A. Well, I don't have a whole lot of experience in the
2 Carolinas, but my understanding of the situation there was that
3 despite having the state marketing orders, there were, there
4 was a lot of packaged milk and bulk milk entering the area and
5 undermining the integrity of those state programs.

6 Q. Thank you. So returning to your statement.

7 A. Division 21, Part 3, Chapter 2, Section 61802(e) of the
8 California Food and Agricultural Code states:

9 And I quote:

10 "It is the policy of this state to promote, foster, and
11 encourage the intelligent production and orderly marketing of
12 commodities necessary to its citizens, including market milk,
13 and to eliminate economic waste, destructive trade practices,
14 and improper accounting for market milk purchased from
15 producers."

16 In Section 61802(h), the importance of orderly
17 marketing is emphasized again. And I quote:

18 "...It is further recognized by the Legislature that in
19 order to accomplish the purposes of this chapter and to promote
20 the public health and welfare, it is essential to establish
21 minimum producer prices at fair and reasonable levels so as to
22 generate reasonable producer incomes that will promote the
23 intelligent production and orderly marketing of market milk in
24 the various classes."

25 /////

1 History of State Efforts to Ensure Orderly Milk Marketing in
2 California

3 California's dairy statutes and regulations that were
4 designed to address orderly marketing, ironically, had their
5 genesis in a failure of Federal regulations to address the
6 marketing problems in the state. Under the 1933 Agricultural
7 Adjustment Act, marketing agreements were set up in several
8 urban market urban fluid milk markets during -- in the state --
9 should say in the state. (See end note (i) on page 40 of
10 Exhibit 79.)

11 Q. That's one of the little Gremlins.

12 JUDGE CLIFTON: All right. So I'm just going to say now,
13 on Page 3, of Exhibit 79, I would like the record copy to
14 change the word in the fourth line down from "during" to "in",
15 is that correct; Dr. Schiek?

16 DR. SCHIEK: It is.

17 JUDGE CLIFTON: Thank you.

18 DR. SCHIEK: When the U.S Supreme Court held that these
19 original marketing agreements were invalid, California was left
20 without any regulatory programs to address the state dairy
21 industry's problems at the time. Before the U.S. Government
22 resolved the problems identified by the court with a 1935 Act
23 and the 1937 Agricultural Marketing Agreements Act or (AMAA),
24 California had begun working on its own solution authorized
25 under state governmental authority. "Producer price regulation

1 was contained in the Young Act of 1935. The legislation
2 designated a third party, the Director of Agriculture, to
3 establish minimum prices to be paid for fluid milk and cream to
4 producers by distributors...A classified pricing system with
5 Class 1 milk for beverage use was the foundation of the minimum
6 price." (See end note (ii) on page 40 of Exhibit 79.

7 BY MR. ENGLISH:

8 Q. So if you could stop there. So unlike, say, the
9 Northeast, where after various pieces of litigation you had
10 milk moving across the borders from Vermont to New York, or
11 vice versa, did California have any distinctions as opposed to
12 those kinds of movements that led to Federal Orders being
13 introduced very quickly in that area?

14 A. Well, California is a big place, first of all, and it's
15 surrounded by a lot of mountains and deserts. And it is
16 somewhat, at least at the time, geographically isolated, and
17 there weren't significant quantities of producer milk crossing
18 state lines. So interstate milk marketing did not create any
19 significant pressures on the state's industry that would lead
20 to disorderly conditions at that time.

21 This geographic isolation and the fact that.
22 Washington DC is a lot farther away from where dairy farmers
23 live in California than Sacramento, I think was a big factor in
24 folks wanting to pursue the state-run system as opposed to a
25 Federal Order. And they kind of held to that even after the

1 option to join a Federal Order came in with the 1937 Act, and
2 basically decided to move forward with the state system.

3 Q. So returning to your statement.

4 A. Regulatory programs in other states were established
5 during the mid-1930's, but when Federal Orders became an option
6 after the passage of the AMAA, many of those states abandoned
7 their milk price regulatory programs. (See end note (iii) on
8 page 40 of Exhibit 79.) In California, the Young Act did not
9 include provisions for market-wide pooling of milk. Individual
10 handler pools were felt sufficient to address the industry's
11 needs and to encourage orderly marketing because the
12 utilization of the Grade A milk supply in fluid milk products
13 was in excess of 80 percent.

14 Numerous adjustments have been made by California State
15 Milk Marketing Orders over the years to keep up with changes in
16 the marketplace and maintain orderly marketing. Some of these
17 have been instigated by state legislation (with conforming
18 regulatory changes following), while others have been purely
19 regulatory in nature. These included several features and
20 adjustments that are described in the following pages.

21 Wholesale and retail pricing. To preserve revenue
22 opportunities for dairy farmers and for milk industry
23 stability, the legislature passed the Desmond Act in 1937.
24 After the legislation passed, the Director of Agriculture began
25 to establish minimum wholesale and retail (collectively

1 referred to as resale) prices. The establishment of minimum
2 resale prices discouraged retailers from pressuring processors
3 to provide packaged milk at lower prices, driving down margins
4 in the industry in a manner that would reduce the number of
5 buyers of Class 1 milk in the marketplace and limiting
6 competition for dairy farmer's milk. The Agriculture
7 Department Director set minimum resale prices to as to cover
8 all reasonable costs, including a reasonable return on
9 investment for reasonably efficient distributors of the various
10 types, and to protect consumers by not requiring them to pay
11 milk prices that were higher than those needed for the
12 maintenance of adequate and efficient distribution facilities.
13 (See end note (iv) on page 40 of Exhibit 79.) The Desmond Act
14 was repealed in 1978 in the face of court actions and an
15 evolving industry where prelim resale prices were no longer
16 deemed necessary.

17 Unlawful Practices and Prohibition of Sales Below Cost.

18 In 1947, the California legislature passed the Dairy
19 Products Unfair Practices Act. After passage of the Act, the
20 Director of Agriculture regulated certain practices such as
21 sales below cost, offering secret rebates, making loans to
22 customers, engaging in false advertising, and offering special
23 pricing to select customers. Also, the new Act addressed the
24 issue of the entities that did not market fluid milk, but
25 instead, marketed only manufactured dairy products. These

1 firms had an advantage over full line distributors who were
2 subject to the Desmond Act. Preventing large or well-funded
3 dairy product marketers from using the low cost sales or
4 prohibited marketing practices to drive competitors out of
5 business was an area of concern. The prevailing view at the
6 time was that such practices could reduce the number of buyers
7 of dairy farmer's milk in the state, reducing competition, and
8 thereby undermining the bargaining power of producers with
9 respect to their interactions with milk buyers.

10 Q. So how did that get implemented by CDFA?

11 A. Well, it led, really to the abandoning of several
12 practices, such as putting milk on special sale for a limited
13 period, or couponing, either directly, cents off on fluid milk,
14 or as part of a cross-promotion like we used to see, buy a box
15 of cereal get a coupon for reduced price on milk, so those
16 kinds of practices were banned, primarily because it was
17 thought that that would lead to a below-cost sale.

18 Q. Returning to your statement, please.

19 A. The Unfair Practices Act was amended in 2000 to allow
20 processors to engage in common marketing practices, but the
21 prohibition of sales below cost was retained. Revised
22 regulations under the authority of the Dairy Marketing Branch
23 that specified how "cost" is determined when evaluating whether
24 couponing or other various promotion programs are in compliance
25 with the Act were established in 2005.

1 Component Pricing and Formula Prices. With the introduction of
2 California's lowfat milk standard in 1962, component pricing
3 was established for Class 1 milk. The lowfat milk standard
4 required that milk sold as lowfat or (2 percent) milk, be
5 required to have 10 percent nonfat milk solids, which required
6 fortification. The basis for establishing how Class 1 prices
7 were paid by handlers was changed to a component basis that
8 required payment for milkfat, or (butterfat), nonfat milk
9 solids (solids not fat or SNF) and fluid carrier which is the
10 portion of milk that is neither milk fat nor nonfat milk
11 solids. This change was put in place to recognize that the
12 degree of fortification required to meet the new lowfat milk
13 standard would vary by processor depending on the average test
14 of its incoming milk.

15 Fluid milk processors receiving milk with a high
16 percentage of SNF would be required to fortify less than would
17 processors receiving milk with a low SNF percentage. This
18 difference could lead, in turn, to unequal raw product costs
19 for competing handlers in the marketing area. By adopting a
20 three-component Class 1 price system, the California State
21 Marketing Order effectively modified its pricing to equalize
22 raw product cost. This equalization was made possible because
23 the SNF component was being explicitly priced and now had a
24 regulated cost both to processors who obtained SNF as part of
25 their producer milk, and to those who purchased it in the form

1 of nonfat dry milk (NFDM) or condensed skim.

2 Q. So what is the concern over unequal raw product cost?

3 A. Well, the concern was that if processors had different
4 raw product cost based on where they sourced their milk,
5 handlers would have an incentive to gauge, to engage in efforts
6 to try to lower their costs by going after that high-test milk,
7 high SNF value milk. So that could lead to disorderly, or
8 inefficient you could say, movements of milk where you have
9 sort of high-test milk leapfrogging closer-end milk to the
10 fluid plant in order to get that raw product cost advantage.
11 And it was also viewed that people were going to want to buy
12 certain producer's milk because it had higher test as opposed
13 to other producer's milk, and that would create competitive
14 pressures on folks that didn't have high-test milk and probably
15 lead to a sort of lower prices in the marketplace.

16 Q. In response to that question, you said disorderly
17 marketing and then you said or inefficient movements of milk.
18 What is your connection between inefficient movements of milk
19 and disorderly marketing?

20 A. Well, inefficient movements of milk is one of the
21 practices or things that go on in the marketplace that would
22 often times be considered disorderly. That is, it's an
23 economic waste because you are spending dollars on
24 transportation to move in distant milk, when there's closer
25 milk available that would serve the purpose.

1 Q. Returning to your statement, please.

2 A. Okay.

3 In 1965, classified pricing based on finished product
4 prices for butter and nonfat -- should say nonfat dry milk.

5 Q. So insert the word "dry" between "nonfat" and "milk"?

6 JUDGE CLIFTON: All right. Now I was still writing that
7 last thought, so I know we're on page 6 and I know we're in the
8 first full paragraph.

9 MR. ENGLISH: We're in the second paragraph, your Honor,
10 and it was the first line.

11 JUDGE CLIFTON: First line.

12 MR. ENGLISH: And it's at the end of the line he said
13 correctly it should be "nonfat dry milk" at the end of that
14 first line, inserting the word "dry".

15 JUDGE CLIFTON: All right. So I would instruct that
16 change. Ms. Elliott, do you know exactly where we were?

17 MS. ELLIOTT: Yes.

18 JUDGE CLIFTON: Thank you.

19 BY MR. ENGLISH:

20 Q. So why don't you start the sentence again and include
21 the word dry, Dr. Schiek.

22 A. In 1965, classified pricing based on finished product
23 prices for butter and nonfat dry milk began to be used to price
24 milk used in manufactured products. Prior to this time, prices
25 for market (Grade A) milk used to make manufactured -- used to

1 make manufactured dairy products, had been established based on
2 the price of manufacturing grade (Grade B) milk. Because of
3 the diminishing quantity of manufacturing Grade A milk being
4 produced in California, the state adapted to the changing
5 marketplace by introducing a formula price based on end product
6 prices, a concept that was eventually fully adopted by the
7 FMMO's in 2000.

8 Formula pricing of Class 1 milk did not begin until
9 1978. The industry recognized that: 1) inflation was leading
10 to the need to adjust Class 1 prices on a frequent basis,
11 2) the calling of frequent hearings was inefficient, and
12 3) resulting price changes were often "behind the curve"
13 because by the time changes resulting from the hearing were
14 implemented, market conditions had changed again. An automatic
15 formula that changed the Class 1 price on a bimonthly basis was
16 adopted in August 1978 to replace the method of establishing
17 fixed price values through hearings. The new Class 1 formula,
18 was a weighted average of three factors: an index of
19 California per hundredweight milk production costs given a 43
20 percent weight, a dairy commodity reference price, weighted 42
21 percent, and the real average weekly earnings of manufacturing
22 workers weighted 15 percent. This three-factor formula value
23 was then compared to a previously established per hundredweight
24 Class 1 base value, and the change was apportioned to each of
25 the components: fat, solids not fat, and fluid carrier, on a

1 proportional basis (40 percent, 40 percent, and 20 percent)
2 respectively.

3 In 1993, the production cost index and manufacturing
4 wage were dropped from the formula and only the commodity
5 reference price was used to adjust Class 1 component values.
6 In 1999, the method of apportioning formula changes relative to
7 the Class 1 "base value" among the Class 1 components was
8 abandoned. The Class 1 price going forward was established
9 directly using a commodity reference price that was based on
10 the CME prices for cheddar cheese 40-pound blocks and Grade AA
11 butter and a milk fat component price formula based on the
12 Chicago Mercantile Exchange (CME) Grade AA butter price. After
13 Federal Order Reform in 2000, the California commodity
14 reference price was changed to reflect the higher of a butter
15 powder value or a cheese value so that the formula would track
16 more closely with Class I prices in the FMMO's.
17 Gonsalves Milk Pooling Act. (See end note (vi) on page 40 of
18 Exhibit 79.) The Young Act of 1935 provided for regulated
19 minimum prices to be paid by fluid milk handlers to producers
20 for the milk they purchased for fluid use. While the bulk of
21 fluid grade milk used in the state was for fluid purposes,
22 there was always some milk that was being used for
23 manufacturing purposes. An amendment to the Young Act in 1937
24 provided for regulated minimum prices to be applied to fluid
25 Grade A milk used for manufacturing purposes.

1 After World War II, the growth of the state's
2 population, coupled with growth in the supply of fluid grade
3 milk, led to a situation where milk utilization could differ
4 substantially across handlers. Given the system of fluid milk
5 contracts and individual handler pools -- and insert effective
6 at the time.

7 JUDGE CLIFTON: Ms. Elliott, this change will be made to
8 the record copies on page 8, first line. Are you there?

9 MS. ELLIOTT: Yes.

10 JUDGE CLIFTON: Thank you.

11 BY MR. ENGLISH:

12 Q. So why don't you start the sentence again, Dr. Schiek?

13 A. Given the system of fluid milk contracts and individual
14 handler pools effective at the time, the blended prices
15 received by dairy farmers supplying different handlers could
16 likewise vary substantially. Because of this, contracts to
17 supply handlers with high fluid milk (Class 1) utilization were
18 especially prized. This put Class 1 handlers in a strong
19 bargaining position with producers and led to practices by some
20 handlers, particularly in Southern California, that eroded
21 producer revenues. In addition, more Class 1 processors were
22 acquiring milk cows and dairy farming operations, which further
23 reduced the Class 1 milk revenues available to be shared among
24 producers. Weakness of producers' cooperatives in this period
25 prevented them from bargaining effectively on behalf of their

1 dairy farmers with Class 1 processors.

2 Q. So given those circumstances, one might have thought
3 that that would be a time when California producers would seek
4 a Federal Milk Marketing Order. What happened or what's your
5 commentary?

6 A. Yeah, I think that would have been an ideal time to
7 start finally thinking about addressing the problem with
8 individual handler pools. They might have considered joining a
9 Federal Order. But keep in mind, we have been operating under
10 state regulation for a long period of time, so I think the
11 producer leadership at the time really felt like pursuing some
12 sort of state solution within California, that mimicked some of
13 the features of Federal Milk Marketing Order pools, market-wide
14 pools, was the answer.

15 Q. So did they pursue some form of legislative action?

16 A. Yeah, they did. There were a couple of attempts made
17 in the early 1960's to get a Milk Pooling bill going, but those
18 ran into opposition in the legislature and weren't successful
19 in moving forward. So a little bit later, in the mid-'60's,
20 producer representatives and handlers got together and began to
21 work together to design a solution to the marketing situation.
22 And they, again, firmly believed that some type of market-wide
23 pooling mechanism was the way to go, similar to the one
24 employed in Federal Milk Marketing Orders, and they felt that
25 held the potential to improve marketing conditions in the

1 state.

2 Q. So returning to your statement.

3 A. Several compromises were made in order to reach the
4 political accord necessary to pass pooling legislation. Dairy
5 farmers in Southern California were unwilling to accept
6 market-wide pooling as typically constructed in FMMO's.
7 Southern California farmers had higher share of contracts with
8 high Class 1 usage handlers. For them, market-wide pooling
9 seemed to be too large a transfer of revenue from South to
10 North. Quota was borne out of this concern as a way for
11 Southern California dairy farmers to preserve some of their
12 historical Class 1 earnings. Without their support, quota
13 legislation could not have passed.

14 Under the quota plan adopted, each producer was
15 allocated production base equal to his or her milk marketings
16 on an average daily basis during July through December of 1966,
17 or the calendar year 1967, and quota allocations to dairy
18 farmers were calculated as 110 percent of their historical
19 sales to Class 1 uses during this period. Any milk marketed in
20 excess of a producer's -- here insert "quota" and "base" and
21 then the word "allocations."

22 JUDGE CLIFTON: All right. Ms. Elliott, I know you are
23 right with it. We're on page 8, did you catch what Dr. Schiek
24 said?

25 MS. ELLIOTT: Yes, just to clarify. It's going to read, "a

1 producer's quota and allocation, I'm sorry, quota and base
2 allocation.

3 DR. SCHIEK: Correct.

4 JUDGE CLIFTON: Good. And would you begin that sentence
5 again, Dr. Schiek?

6 DR. SCHIEK: Certainly.

7 Any milk marketed in excess of a producer's quota and
8 base allocations was termed overbase milk. Revenues from
9 Class 1 (fluid milk) mandatory Class 2 (cream and cultured
10 products) uses were allocated to producers based on their quota
11 holdings. So quota revenues and the amount of quota producers
12 received were explicitly linked to the Class 1 market.

13 JUDGE CLIFTON: If I could interrupt, I don't understand
14 the use of mandatory in that sentence.

15 DR. SCHIEK: Mandatory means that they are products of
16 mandatory Class 2 use is milk used in products that must be
17 made from market grade milk.

18 JUDGE CLIFTON: Oh.

19 DR. SCHIEK: We have, I think Mr. Shippelhouse discussed
20 that when he was here. I believe the only Class 2 product that
21 isn't required to be made from market grade milk is eggnog.

22 JUDGE CLIFTON: And is market grade synonymous with
23 Grade A?

24 DR. SCHIEK: We use them interchangeably. We have had some
25 discussions about that, that we think that all market milk

1 would be Grade A, but not all Grade A milk would necessarily be
2 market milk.

3 JUDGE CLIFTON: Do you remember where you were before I
4 interrupted you?

5 DR. SCHIEK: Yes. Well, I was in the middle of a sentence,
6 revenues from Class 1.

7 BY MR. ENGLISH:

8 Q. So why don't you start with the sentence again.

9 A. Okay. Revenues from Class 1 fluid milk and mandatory
10 Class 2 -- let me start again.

11 Revenues from Class 1 (fluid milk) and mandatory
12 Class 2 (cream and cultured products) uses were allocated to
13 producers based on their quota holdings, so quota revenues and
14 the amount of quota producers received were explicitly linked
15 to the Class 1 market. This system was approved by producers
16 in a referendum held on September 10, 1968, and the plan became
17 effective in July, 1969. Base and overbase received lower
18 class allocations. As the state's Class 1 sales grew, it was
19 anticipated that new quota allocations would be given to
20 producers with lower quota holdings, up to the point where
21 quota was equal to 95 percent of each producer's base
22 marketings or production base.

23 JUDGE CLIFTON: Should we add that?

24 DR. SCHIEK: I think so.

25 JUDGE CLIFTON: All right. Let us add that on page 9, at

1 the top, the last line of that first part paragraph, after the
2 word, the phrase, producer's base marketings, we add what?

3 DR. SCHIEK: Or production base.

4 JUDGE CLIFTON: Or production base.

5 DR. SCHIEK: Okay.

6 JUDGE CLIFTON: Thank you.

7 DR. SCHIEK: At such point, the producers were said to be
8 equalized.

9 BY MR. ENGLISH:

10 Q. So why don't you stop there for a second. I just want
11 to tie this together with the equalized that was discussed
12 earlier.

13 Do you have any other commentary or just want to
14 describe what that equalized means because we have seen
15 exhibits where that phrase is used.

16 A. Yes. The notion of equalization, and I think we'll
17 probably, I'll probably get into this more in my testimony, but
18 it was basically to design or to set a target level that, where
19 producers would essentially all have similar holdings of quota,
20 that 95 percent of production base. So the idea was that if
21 new quota was available, it would be given to low quota holders
22 first, or at least with a larger share, and that would allow
23 them to kind of catch up to those folks in, say, Southern
24 California who initially got higher quota allocations.

25 Q. Okay. Why don't you continue with your statement on

1 page 9.

2 A. At the time of pooling was instituted in California,
3 the state's population was growing rapidly, as was the fluid
4 milk demand. The producer leadership who were instrumental in
5 designing this system of pooling, believed that eventually all
6 producers would be equalized and the quota system become
7 unnecessary. But at the beginning, the prevailing view among
8 industry leaders was that without the quota system, demand
9 growth for fluid milk would outstrip production group.

10 JUDGE CLIFTON: Out what?

11 DR. SCHIEK: Production growth, thank you.

12 Consequently, quota was -- I have no idea where the "A"
13 went.

14 JUDGE CLIFTON: Okay. Page 9, the very middle of the page
15 we're going to make the W space S, was.

16 MR. ENGLISH: I missed it five times, too.

17 JUDGE CLIFTON: Dr. Schiek, when you are ready to resume,
18 if you would read that sentence again beginning with
19 consequently.

20 DR. SCHIEK: Consequently, quota was viewed at the time as
21 a necessary means of ensuring that there would be adequate
22 supplies of fluid grade milk and fluid products for consumers.
23 In such an environment, it was expected that new producers
24 could be easily accommodated with additional quota. As it
25 turned out, production outstripped fluid milk demand in the

1 state, and fluid milk utilization in the market declined
2 sharply over time, exactly the opposite of what had been
3 expected. So even though the foundational basis and economic
4 rationale of the quota system evaporated, the institution of
5 quota endured.

6 As the pooling programs being discussed in the late
7 1960's, there was also concern about the growing number and
8 volume of fluid milk bottling operations that also had dairy
9 farming operations. These entities produced a portion, or in
10 some cases, the entire amount of the milk they processed. The
11 prospect of market-wide pooling concerned the larger operations
12 among these entities, because some of advantages they had under
13 the prevailing system of individual handler pools (such as the
14 income benefit they gained from their farms' direct Class 1
15 sales to their plants) would be relinquished.

16 To head off producer-handler opposition to pooling,
17 political concessions were made regarding the regulatory
18 treatment. Smaller producer-handlers were exempted entirely
19 from pooling and received no quota allocation, while larger
20 entities were given the option of foregoing quota draw from the
21 pool that they were entitled to as dairy farmers, and instead,
22 were allowed to exempt or (deduct) these pounds from their
23 processing operations Class 1 obligation to the pool. So while
24 such exemption was contrary to the central notion of pooling,
25 that is, the sharing of Class 1 revenues among all dairy

1 farmers in the market -- and here I have got a change. It
2 was -- it was incorporated in the proposed pooling law for
3 political expediency.

4 JUDGE CLIFTON: "But made part of" sounds great. Why do
5 you want to make this change? That's okay, you don't have to
6 explain. All right. So tell me again, beginning with "it was"
7 how that should read, and Ms. Elliott and I will capture it at
8 the same time on page 10.

9 DR. SCHIEK: Strike "made part of the state" and then add
10 in its place "incorporated in the proposed."

11 JUDGE CLIFTON: I see now the reason for the change. All
12 right. We will make that change, striking "made part of the
13 state" and inserting instead "incorporated in the proposed" and
14 would you read that sentence again, Dr. Schiek?

15 DR. SCHIEK: Okay.

16 So while such exemption was contrary to the central
17 notion of pooling, that is, the sharing of Class 1 revenues
18 among all dairy farmers in the market, it was incorporated in
19 the proposed pooling law for political expediency.

20 The possibility of market-wide pooling also created
21 concerns for Class 1 processors. In the discussions leading up
22 to the drafting of pooling legislation, processors voiced the
23 concern that they would not be able to continue drawing milk
24 supplies as they had done under the system of individual
25 handler pools. The handler pools created a direct incentive

1 for producers to supply the Class 1 market because of the
2 higher price that handlers with high Class 1 usage were able to
3 offer dairy farmers. Class 1 processors believed that pooling
4 would essentially make producers indifferent as to where they
5 shipped their milk, and as a result, they would have to pay
6 additional premiums above the already higher Class 1 price in
7 order to attract a sufficient milk supply.

8 In order to secure milk bottler support for pooling
9 legislation, or at least to eliminate their opposition, the
10 producer leadership promised that enough milk would be
11 available to satisfy the Class 1 market. (See end note (vii)
12 on page 40 of Exhibit 79.) To help ensure that this promise to
13 serve the Class 1 market would be kept, the original California
14 Milk Pooling Plan established location differentials to provide
15 dairy farmers with economic signals that would encourage them
16 to ship milk to designated deficit counties. These location
17 differentials were added to, or deducted from, quota payments
18 to dairy farmers based on the plant of first receipt. Later,
19 as overbase milk production began to increase and to represent
20 a large share of the milk produced in the state, location
21 differentials that applied solely to quota milk became less
22 effective at making sure milk was available to Class 1 plants.
23 Milk Movement Incentives. In 1979, milk movement requirements,
24 also known as "call provisions" were established as part of the
25 milk stabilization and marketing plans, also referred to as

1 "stab. plans." Call provisions required that manufacturing
2 plants that participate in the pool, make specified percentage
3 of the quota milk they receive available to plants processing
4 Class 1 products, if requested. Thus, if producers do not have
5 a direct economic incentive large enough to encourage them to
6 ship milk to Class 1 plants, the call provisions allow for the
7 plants to request the milk and it must be made available.
8 Unfortunately, these are not perfect mechanisms for moving milk
9 to the Class 1 markets. Manufacturing plants are sometimes
10 loathe to give up milk when requested because of the
11 inefficiencies they incur in their plants when throughput milk
12 volumes are less than planned. The call provisions do not
13 specify a maximum charge on milk surrendered for Class 1 use,
14 so the possibility of high "give up" charges exists. Still,
15 they do provide for supplies to be made available for Class 1
16 uses, if requested.

17 A system of transportation credits was established in
18 1981.

19 BY MR. ENGLISH:

20 Q. So what do those credits do that were established in
21 1981?

22 A. Credits are, transportation credits are monies that
23 apply to plant-to-plant movements of milk to provide an
24 incentive for shipping that milk to offset the cost of hauling
25 milk from a, sort of a plant or supply plant in a surplus

1 location to a Class 1 plant in a deficit county.

2 Q. And what do they apply to?

3 A. So they apply to those kinds of shipments, shipments to
4 Class 1 plants only, and between designated supply counties and
5 designated deficit counties.

6 Q. And what products do they apply to?

7 A. Just Class 1. It's not any other. So fluid milk
8 products.

9 Q. How about cream?

10 A. It would not be cream.

11 Q. Okay. Continue, please.

12 A. Okay.

13 Transportation credits, oh, sorry. The need for
14 transportation credits arose from the consolidation of
15 marketing areas in the state and the insufficiency of area
16 differentials (difference in Class 1 prices in the various
17 marketing areas) to cover the cost of the milk movements. The
18 principle that had been used historically for setting
19 transportation credit rates, has been the cost of moving milk,
20 less any area differential between the plants. Usually there
21 is some shortfall in the credit rate, and the shortfalls
22 typically increased with distance to encourage closer milk to
23 move first. The credits provided a way to encourage
24 plant-to-plant movements of milk, but did nothing to encourage
25 dairy farmers to move milk to fluid bottling plants.

1 Q. So let me go back to the previous sentence, about the
2 idea of the shortfall and the rate did not typically increase
3 for distance. Would that be a concept when you are trying to
4 encourage closer milk to move first, of trying to encourage
5 efficient movement of milk?

6 A. Yeah, that's what the idea is, that by providing more
7 sort of full reimbursement on the closer end milk, that milk
8 will likely, has an economic incentive to move before more
9 distant milk would move to serve those needs.

10 Q. Why don't you continue now, the next paragraph.

11 A. Transportation allowances were instituted in 1983 as a
12 replacement for location differentials as a means of
13 encouraging milk movement to Class 1 plants in deficit markets.
14 The allowances applied to all California Grade A milk moving
15 from farms to plants located in qualifying areas that process
16 more than 50 percent of the milk they receive into Class 1, 2,
17 or 3 uses. Also, farm milk shipments to cooperative plants
18 located in designated deficit areas are eligible for
19 transportation allowances if the plant supplies at least 40
20 percent of the milk it receives for Class 1 uses. These
21 allowances provide some compensation to producers for the cost
22 of hauling from the dairy farm to the deficit area plant.

23 The principle for establishing transportation allowance
24 rates begins with a difference between the cost of the local
25 haul in surplus milk production zones, and the cost of the haul

1 from the production location to the deficit area. For milk
2 located nearer to the deficit area, the allowance rates were
3 set equal, or nearly equal, to the haul cost difference just
4 described. For more distant milk, the compensation for the
5 haul cost difference is shorted with the goal of encouraging
6 more efficient milk movements.

7 Q. Just to be clear, I think on page 12, I think you have
8 corrected it, you said "for more distant milk" and the text
9 right now says "for more distance milk." I think you read it
10 the way you intended it, for more distant milk. I'm sorry, on
11 the version you are looking at, it's on page 14. The paragraph
12 you were just reading, for the sentence, for more distant milk,
13 the compensation for the haul cost. Do you see that?

14 Are you in the right place? Let me come help.

15 A. What paragraph. Distant.

16 JUDGE CLIFTON: All right. I would like, Ms. Elliott, to
17 make that correction on the record copies. We're on page 12,
18 moving up from the bottom, it's the last full paragraph, next
19 to the last line, and that line will read "more distant milk,"

20 BY MR. ENGLISH:

21 Q. All right. Why don't you start with the next
22 paragraph?

23 A. Okay.

24 Both transportation allowances and credits have been
25 adjusted many times since they were instituted in the early

1 1980's. The ability to keep these milk movement incentives
2 updated and reflective of current costs and marketing
3 conditions has helped greatly, has been helped greatly by
4 biannual hauling cost surveys conducted by CDFA. Among other
5 things, they provide information on the hauling costs that are
6 key to setting transportation allowance and credit rates.

7 JUDGE CLIFTON: If I might ask, Dr. Schiek, does biannual
8 mean twice a year or every other year?

9 DR. SCHIEK: Every other year. No, it does mean every
10 other year, so that's a good catch, those should say
11 semi-annual.

12 JUDGE CLIFTON: Well, that, actually, no, semi-annual means
13 twice a year. Which do you want?

14 DR. SCHIEK: It is twice a year.

15 JUDGE CLIFTON: Oh, it is twice a year?

16 DR. SCHIEK: Uh-huh.

17 JUDGE CLIFTON: See, I think biannual can mean either one,
18 you just have to know. But you think semi-annual will make it
19 clear that it's twice a year?

20 DR. SCHIEK: I think it will make it clear that it's twice
21 a year.

22 JUDGE CLIFTON: Good. So on the record copy, page 12,
23 third line up, last word, I'm going to ask Ms. Elliott to
24 strike biannual and insert instead semi-annual.

25 MS. ELLIOTT: Okay.

1 JUDGE CLIFTON: And if you don't mind, Dr. Schiek, please
2 read the sentence that contains that again.

3 DR. SCHIEK: The ability to keep these milk movement
4 incentives updated and reflective of current costs and
5 marketing conditions has been helped greatly by semi-annual
6 hauling cost surveys conducted by CDFA. Among other things,
7 they provide information on the hauling costs that are key to
8 setting the transportation allowance and credit rates. They
9 also contain information about how much milk is moving to each
10 of the various supply area from -- that should be from each of
11 the various supply areas -- to each of the deficit areas, so
12 changes in supply patterns can be identified and changes made
13 to the structure of allowances and credits as needed.

14 JUDGE CLIFTON: Ms. Elliott, with regard to page 13, the
15 very top line, I would like you to insert the word "from" after
16 the word "moving". And Dr. Schiek, if you would just read
17 again, beginning with the words "contain information about how
18 much".

19 DR. SCHIEK: Contain information about how much milk is
20 moving from each of the various supply areas to each of the
21 deficit areas, so changes in supply patterns can be identified
22 and changes made to the structure of allowances and credits as
23 needed.

24 Historically, the goal of the allowances and credits
25 has been to provide only such transportation assistance as is

1 needed to get the milk to move. Originally, the systems' goal
2 and intent was not to equalize hauling rates among producers,
3 but to provide only the assistance necessary to ensure that
4 Class 1 plants had a milk supply available to them at something
5 close to order prices. Dairy farmers whose best or only market
6 alternative (lowest cost to market) is a fluid milk plant
7 usually did not receive any transportation allowance, because
8 they would ship their milk to a Class 1 plant without the
9 incentive. In recent years, there have been some exceptions
10 made to this principle to address market changes in specific
11 regions. Likewise, milk shipments to fluid milk plants located
12 in the San Joaquin Valley were not eligible for allowances or
13 credits because they are surrounded by more than sufficient
14 milk supplies for their needs, and are not disadvantaged
15 relative to local manufacturing plants when it comes to
16 attracting milk to their plants.

17 Producer's Security Trust Fund. There was a major bankruptcy
18 of the state's largest milk buyer, (Knudsen-Foremost) in the
19 mid-1980's. As a result of the bankruptcy, many producers were
20 left unpaid for the milk they had shipped. In 1987, the
21 California Legislature passed a law establishing the Milk
22 Producers Security Trust Fund. This fund was designed to have
23 enough money to cover a default of the state's largest
24 proprietary milk purchaser. It was created through assessments
25 on Class 1, 2, and 3 processors. Once the Fund balance reaches

1 its target level of 110 percent of the value of monthly milk
2 purchases of the state's largest processor, assessments stop.
3 Beneficial interest prohibitions exclude producers from
4 collecting from the Fund.

5 BY MR. ENGLISH:

6 Q. So what's the implication of that?

7 A. So if producers have an ownership interest in the
8 entity that defaults, they are not eligible to collect on the
9 Fund.

10 Q. So if the entity is a cooperative?

11 A. So cooperatives are not covered for their member milk
12 in the event that they default.

13 Q. What about paying into the Fund?

14 A. Cooperatives aren't required to pay into the Fund
15 either on their member milk. Now, they can, producers can
16 collect in the event of a cooperative default if they are
17 non-member producers, if they didn't have an ownership in the
18 cooperative. And cooperatives do pay into the fund on their
19 non-member milk, if they receive non-member milk.

20 Q. Now, there's been some discussion in this record about
21 consolidation in the dairy industry, consolidation in the dairy
22 industry in California, were there any implications for the
23 Producer Security Trust Fund?

24 A. Yeah, there have been, and there's actually two big
25 implications. One, consolidation resulted in much larger

1 purchasers. I mean, the 1980's, Knudsen-Foremost was thought
2 to be a very big processor. It would not be that big by
3 today's definition. So there have been much larger processors
4 through consolidation, much larger companies buying larger
5 volumes of milk.

6 And the other thing that's happened, of course, is with
7 the volatility that we have had in the globalization of market.
8 Milk prices are much higher than they, at times are much higher
9 than they have been historically, and that creates an issue
10 because the value of the largest purchaser of milk's monthly
11 purchase rises with that value. So if we go from an average
12 price or price of milk that the processor has to pay of \$14 a
13 hundredweight up to \$22 a hundredweight, that makes a
14 difference in terms of what the Fund requirement is.

15 Q. Has the California Legislature made any changes to the
16 Fund?

17 A. Yeah, in 2006 there were changes made to the funding
18 structure in terms of how that targeted amount of coverage is
19 attained, and I was going to discuss those in my testimony.

20 Q. Okay. So continue, then.

21 A. Okay. Because the state --

22 JUDGE CLIFTON: Let me ask if this is a good stopping
23 point.

24 MR. ENGLISH: It is for me, your Honor. I believe it for
25 the witness as well.

1 JUDGE CLIFTON: Okay. Good. So were you about to read,
2 Dr. Schiek, the first line on page 14?

3 MR. ENGLISH: Page 14 of your version, yes, your Honor.

4 DR. SCHIEK: Yes, I was.

5 JUDGE CLIFTON: Okay. Let us stop there. Mr. English, do
6 you want about 10 minutes or about 15?

7 MR. ENGLISH: The witness?

8 DR. SCHIEK: 10 would be fine.

9 JUDGE CLIFTON: Okay. Good. So it is 2:48. Please be
10 ready to go at 3:00.

11 (Whereupon, a break was taken.)

12 JUDGE CLIFTON: We're back on record at 3:03. We're in
13 Exhibit 79, at the top of page 14. Mr. English.

14 BY MR. ENGLISH:

15 Q. Dr. Schiek, please continue.

16 A. Because the state's largest proprietary milk purchasers
17 were now cheese companies rather than fluid milk bottling
18 companies, it seemed inequitable to continue requiring handlers
19 of Class 1, 2, and 3 products to be the only ones contributing
20 to the Fund balance. By the mid-2000's, the monthly purchases
21 of several of the state's largest proprietary milk processing
22 companies exceeded the Fund balance by millions of dollars.
23 Two changes were then made to the funding. Rather than
24 continuing to assess processors in order to bring the Fund up
25 to its target level, following legislation passed in 2006, the

1 largest companies were able to post financial instruments to
2 cover the gap between the Trust Fund balance and 110 percent of
3 the value of their monthly, average monthly milk purchases.
4 (See end note (viii) on page 40 of Exhibit 79.) If, however,
5 the Fund is depleted and assessments are needed to rebuild it
6 to its target level -- and then strike "at the time the new
7 funding mechanisms were implemented."

8 JUDGE CLIFTON: Let us do that now. We are on page 14 in
9 the middle, so just after the words "target level" we will
10 strike "at the time the new funding mechanisms were
11 implemented," is that correct, Dr. Schiek?

12 DR. SCHIEK: That's correct.

13 JUDGE CLIFTON: All right. So that change will be made on
14 the record copies.

15 DR. SCHIEK: Okay. I'll start with that sentence again, if
16 that's okay.

17 If, however, the Fund is depleted and assessments are
18 needed to rebuild it to its target level, assessments would be
19 required on proprietary handlers of Classes 1, 2, 3, 4a, and
20 4b. This was another example of an instance where California
21 had successfully managed to update its dairy regulatory system
22 to adapt to changes in the structure of the marketplace.
23 Class 4a and Class 4b pricing. In 1980, the Class 1
24 utilization in California fell below 50 percent for the first
25 time. (See end note (ix) on page 40 of Exhibit 79. The 1980's

1 were a period of tremendous growth in the dairy product
2 manufacturing in California, particularly for butter/powder and
3 cheese. Prior to 1982, storable manufactured products such as
4 butter, milk powders, and cheese were all grouped together as
5 Class 4. As I have already noted, beginning in 1965, Class 4
6 prices were calculated based on the market prices for butter
7 and nonfat dry milk. In 1982, the Class 4 price was split into
8 Class 4a (butter and milk powders) and Class 4b (cheeses other
9 than cottage cheese), but both of these class prices continued
10 to be calculated from butter and nonfat dry milk prices.
11 Implied milk use values for Class 4a and Class 4b tracked
12 closely in the early 1980's, because dairy commodity prices
13 were often at CCC intervention levels. So at the time, cheese
14 makers in California were able to tolerate their milk cost
15 being based on the price of products they did not make. The
16 cheese industry continued to grow, and in 1986, cheese
17 production exceeded butter and nonfat dry milk production on an
18 annual basis for the first time.

19 However, by the late 1980's, the implied value of milk
20 based on nonfat dry milk and butter prices, began to rise
21 significantly, while the cheese use milk value did not keep
22 pace. The result was that cheese makers in the state who were
23 buying their milk priced off a butter-powder market, were not
24 able to profitably market their product. The butter/NFDM
25 based milk price was simply too high. So in 1989, a new Class

1 4b formula was established based on prices for cheese and
2 Grade B butter (to represent the value of whey cream). No
3 value for the skim portion of the whey was incorporated into
4 the Class 4b formula at its inception. However, by adding a
5 new class formula that addressed the problem cheese makers were
6 experiencing, CDFA was making it possible that market outlets
7 for California dairy farmers' growing milk supplies would be
8 available.

9 BY MR. ENGLISH:

10 Q. So let me stop you there. As I was reading that in the
11 last several days, I was struck by the parallelism, but the
12 mirror image, with respect to Class IIIa which, would you agree
13 that in the Federal Orders that what had happened was you had
14 the M-W price, which was based largely on cheese production --

15 A. It was.

16 Q. -- and Class IIIa came about because nonfat dry milk
17 production entities in the Federal Order system, actually after
18 1989, couldn't make that formula work for them; is that
19 correct?

20 A. That's my understanding, yes.

21 Q. All right. Thanks. You may continue.

22 A. Quota Reform. By the early 1990's, the quota program
23 was experiencing pressure as a result of the rapid growth in
24 milk production and the growing number of dairy farmers whose
25 income was derived largely, or even entirely, from the overbase

1 price. These were producers who owned little (as a share of
2 their total production) or no quota. Before 1994, quota
3 revenues were derived from Class 1, 2, and 3 prices. Overbase
4 prices were derived from Class 4a and 4b prices. As a result,
5 the difference between quota and overbase prices could vary
6 widely by month. As the amount of overbase production grew,
7 producers with little or no quota were dissatisfied with the
8 fact that they had no access to the higher Class 1 revenues in
9 the market. Quota holders, on the other hand, were happy with
10 the status quo. After considerable industry discussion, a
11 quota reform bill was passed in 1993 and became effective in
12 1994. The new bill established the quota price at 19 and a
13 half cents per pound of quota SNF above the overbase SNF price,
14 an amount equal to \$1.70 per hundredweight for milk at
15 standardized test (3.5 percent milk fat and 8.7 percent solids
16 not fat.)

17 JUDGE CLIFTON: Now, I want to make clear that when you
18 said an amount equal to, what you were referring to is a dollar
19 amount. So could you take that sentence from the top line of
20 page 16, begin with the phrase "an amount equal to" and read
21 the rest?

22 DR. SCHIEK: So an amount equal to the \$1.70 per
23 hundredweight for milk at standardized test (3.5 percent milk
24 fat, 8.7 percent solids not fat.) In establishing the quota
25 premium level at \$1.70 per hundredweight, the historic value of

1 quota in comparison to overbase was explicitly considered.
2 Consequently, the notion that quota derives its value from the
3 Class 1 and other higher-valued uses, remains an important
4 concept. The fact that the "call provisions" mentioned earlier
5 require dairy product manufactures to make quota milk available
6 for Class 1 usage, is another such linkage. As was noted
7 earlier, an additional change made at the time of quota reform
8 was to abandon the historic three-factor formula that used a
9 weighted average of the commodity reference price, cost of
10 production index, and manufacturing wage index, and replaced it
11 with a formula that would make changes to the Class 1 base
12 values using only the dairy commodity reference price factor.
13 Class 1 Price Adjustments. Class 1 price adjustments have been
14 a frequent subject of California milk --

15 JUDGE CLIFTON: I need to stop you. Page 16 in the middle,
16 where you are now, in the heading, is that Class 1 an Arabic 1?

17 DR. SCHIEK: That should be an Arabic 1.

18 JUDGE CLIFTON: Okay. It looks like a Roman numeral.
19 These are hard to see. But I'm just going to ask Ms. Elliott
20 to make it clear in the heading, the middle of page 16, that
21 that's an Arabic 1, Class 1, so I would strike what's there and
22 just do the best you can to write an Arabic 1.

23 MR. ENGLISH: Like we said, the presumption was an Arabic
24 1, but it looks like the presumption is overcome. Your
25 correction is appreciated.

1 JUDGE CLIFTON: Thank you.

2 DR. SCHIEK: They look a lot alike, the distinction is hard
3 to see sometimes.

4 JUDGE CLIFTON: Exactly. So if you would begin again with
5 the heading, Dr. Schiek.

6 DR. SCHIEK: Class 1 price adjustments. Class 1 price
7 adjustments have been a frequent subject of California milk
8 pricing hearings. Before a Class 1 formula was adopted,
9 Class 1 prices were set at a particular level by the Secretary
10 through a hearing decision, and the only way the price could be
11 changed was through another hearing. After adoption of the
12 pricing formula in the late 1970's, Class 1 prices adjusted
13 automatically, but the three-factor formula resulted in price
14 levels that were noticeably lower than Class I prices in
15 FMMO's. Initially, the combination of low California milk
16 production costs, relatively high Class 1 utilization, and
17 sparse production in surrounding states, meant that this large
18 price disparity did not have any adverse consequences and was
19 appropriate for the state's industry. Supplies were adequate
20 to meet Class 1 and mandatory Class 2 needs, plus a reserve.
21 Milk moving between California and surrounding states was a
22 small portion of the total Class 1 use, and such shipments were
23 fairly consistent and based on established business
24 relationships

25 BY MR. ENGLISH:

1 Q. Now, you earlier testified though, that as time went
2 on, the plan of quota didn't quite work out because production
3 went up and Class 1 use did not follow. So what happened at
4 that point?

5 A. The main issue, and probably the divining feature of
6 the California dairy industry over the last 30 or 40 years has
7 been one of a pretty dramatic growth trend. And supplies,
8 actually in beginning in the 1980's and '90's the growth rate
9 accelerated. We were growing at over 4 percent per year milk
10 production, that's compounding every year. There was just a
11 lot of supplies entering the market. Producer incomes, because
12 they had been used to higher Class 1 utilizations, producer
13 incomes were under pressure from the fact that more milk was
14 going into manufacturing uses and more producers were receiving
15 a larger percentage of their price as an overbase price,
16 opposed to quota price.

17 Q. So effectively the percentage of Class 1 was actually
18 declining?

19 A. The percentage of Class 1 was declining because milk
20 production was growing faster than Class 1 sales.

21 Q. And that added to the income pressure for dairy
22 farmers?

23 A. It did, and kind of resulted in a sort of blending down
24 of the price so that it began, you know, the weighted price
25 between a producer's quota price that they received, more and

1 more there was production received an overbase price that was
2 lowered, that lowered their weighted average price, sort of
3 individual blend, if you want to think about it that way.

4 Q. How about the margin price?

5 A. Their marginal price was at the overbase price.

6 Q. So it was going down, too?

7 A. It was going down because -- I don't know that it was
8 going down. The marginal price was at the overbase price.]
9 Whether it was going down or not was really more dependent on
10 what the national level price was.

11 Q. But more and more of it was in the marginal price?

12 A. More and more of it was in the marginal price, that's
13 correct.

14 Q. All right. Continue then on the top of page 17.

15 A. Producers began to look to Class 1 price increases as a
16 way to increase their revenues. Initial adjustments took the
17 form of changes to the base values of milk components in the
18 Class 1 formulas. As Class 1 prices increased, alignment
19 issues with surrounding markets took on increased economic
20 significance because of growing milk production in surrounding
21 states. California dairy farmers who were dissatisfied with
22 California Class 1 prices -- who were dissatisfied that
23 California Class 1 prices were lower than those in nearby
24 states, were successful in amending the California Food and
25 Agricultural Code (Section 62062.1):

1 And I quote the section:
2 "Any designation of a Class 1 price by any method or formula
3 that is used to develop Class 1 prices paid to producers in the
4 various marketing areas, shall provide on a calendar year
5 basis, a statewide weighted average minimum price level for a
6 hundredweight of milk testing 3.5 fat and 8.7 solids not fat,
7 that is in reasonable relationship with minimum Class 1 milk
8 prices paid to producers in contiguous states. If the
9 statewide weighted average Class 1 prices paid to producers are
10 not in a reasonable relationship with the Class 1 prices paid
11 to producers in contiguous states, the Secretary shall
12 immediately hold a hearing to consider adjustments to the
13 Class 1 prices."

14 Now, my interpretation is that while this provision did
15 not, and still does not require that prices be equal to those
16 in surrounding states, it did provide impetus for dairy farmer
17 efforts to increase Class 1 prices through the hearing process.
18 One change made in the mid-1990's resulted in the adoption of a
19 Class 1 pricing formula that computed the commodity reference
20 price (CRP) as the "higher of" a butter-powder value or a
21 cheese-whey cream value, also known as whey fat value. When
22 prices diverged in a manner where butter-powder values were
23 higher than those derived from cheese and whey fat, California
24 Class 1 prices moved higher than those in contiguous states,
25 which were calculated using an FMMO basic formula price (BFP)

1 that was linked to a Minnesota-Wisconsin (M-W) price series for
2 Grade B milk. The M-W series tended to reflect a cheese milk
3 value because cheese making was more dominant in the Upper
4 Midwest than butter-powder manufacturing.

5 When California Class 1 prices rose to levels
6 sufficiently above milk prices in contiguous states, milk
7 movements into California for Class 1 use began to increase.
8 Out-of-state milk supplies began to displace milk supplies in
9 California for Class 1 uses, and milk movements were becoming
10 uneconomic as nearby milk was displaced by milk hauled from
11 further distances outside the state. Hearing decisions in the
12 mid-1990's resulted in a couple of key changes. Class 1
13 component values were reduced --

14 JUDGE CLIFTON: Read it again.

15 DR. SCHIEK: Excuse me, should be Class 1 component base
16 values, not based -- base values.

17 JUDGE CLIFTON: Do we have to strike a D?

18 DR. SCHIEK: Strike a D.

19 JUDGE CLIFTON: Okay. So on page 18, down from the top six
20 lines, that line will read "1 component base values" and we're
21 just striking the D, Ms. Elliott.

22 MS. ELLIOTT: Okay.

23 JUDGE CLIFTON: Thank you.

24 DR. SCHIEK: Class 1 component base values were reduced and
25 the "higher of" CRP was replaced by one based solely on the

1 "cheese-whey fat" value so that prices would track better with
2 prices in FMMO markets. Also, the Pooling Plan was amended to
3 allow a portion of the revenue from Class 1 sales made by
4 out-of-state producers to be pooled, thereby reducing the
5 attractiveness of the California market to out-of-state
6 producers. The Pooling Plan amendment was successfully
7 challenged in court. Despite the state's lack of ability to
8 maintain its Pooling Plan changes, the reduction in Class 1
9 prices resulted in a better relationship to prices in
10 surrounding states and was sufficient to discourage continued
11 growth in shipments by out-of-state milk suppliers into the
12 market. As a result, the amount of bulk milk entering the
13 state returned to more historically normal levels.

14 BY MR. ENGLISH:

15 Q. So let me interrupt you there. When you talk about the
16 Pooling Plan was successfully challenged in court, is that what
17 is known as the Hillside Dairy case that was had been discussed
18 earlier in this proceeding?

19 A. It is.

20 Q. And in your, the last two sentences reflect that your
21 view of the amount of bulk milk in the state has returned to
22 more historically normal levels, was that reflected on
23 Exhibit 61 that the state put in that showed sort of a numbers
24 going up into the late '90's early 2000 period, and then coming
25 back down?

1 A. It is partially reflected, if that table had gone back,
2 because we're talking about the 1990's here, if that table had
3 gone back into the early '90's it would have been clearer, but
4 yeah, that's what happened. And that was, I believe, Table
5 CDFA-X, if I'm remembering.

6 Q. Great. So continue.

7 A. In the late summer of 1999, CDFA called a hearing on
8 its own motion to consider changes to the Class I pricing
9 formula. As a result of this hearing, the frequency of pricing
10 changes was changed from bimonthly to monthly. Also, the last
11 ties to the 1970's price formula, the base value concept, was
12 eliminated and Class 1 prices were calculated directly using
13 the CRP. At this time, the formula took the basic structure,
14 that remains today.

15 Continued "Fine Tuning" of Class 1, 2, and 3 Price Formulas.
16 Since 2000, there have been several hearings to update the
17 Class 1 formula. The "higher of" CRP was put in place in early
18 2000 to account for the fact that the "higher of" concept was
19 employed got FMMO Class I formula. An important change occurs
20 in 2006 when a dry whey factor was added to the Class 1 CRP to
21 make it track better with FMMO Class 1 -- should say Roman
22 Numeral I -- price movements.

23 JUDGE CLIFTON: Good. Let's make that change. We're at
24 the top of page 19, the second line. The Arabic 1 will now
25 become a Roman numeral I. Thank you, Ms. Elliott.

1 DR. SCHIEK: In 2008, the Class 1, Class 2 and Class 3
2 prices were reduced to restore their alignment with comparable
3 FMMO prices when the FMMO price levels were reduced to account
4 for increases in the manufacturing allowances used in the
5 Class III and Class IV formulas. In that hearing, the
6 California dairy cooperatives trade association (The Alliance
7 of Western Milk Producers) had asked for a \$1.00 per
8 hundredweight increase in the regulated price for Classes 1, 2,
9 and 3. The proposed changes would have resulted in regulated
10 prices that were higher than those for corresponding milk
11 classes in the FMMO's. During my time at Dairy Institute, I
12 have observed that the California cooperatives' reliance on the
13 "national dairy pricing grid" has generally been limited to
14 those situations where adopting an FMMO regulated price level
15 would have resulted in a higher price than under the California
16 State Order. The cooperatives have had little interest in
17 advocating for price reductions, except as it pertains to
18 prices for classes of products that they produce in their own
19 plants.

20 At various times, there have an temporary increases in
21 the Class 1 and other class prices when dairy farm margins
22 tightened due to high feed costs or lower dairy commodity
23 prices. The pattern has been that CDFA has made adjustments
24 whenever necessary to deal with changing market conditions and
25 changing dairy price policies in the rest of the country so

1 that milk marketing in California will remain orderly and so
2 that the prices are set at levels that account for, and are
3 responsive to, market forces originating both inside and
4 outside the state.

5 Updates to Manufacturing Class Formulas. Hearings were held
6 frequently throughout the 1980's, 1990's, and 2000's to adjust
7 the milk Class 4a and Class 4b milk pricing formulas to
8 changing cost and market conditions. The dominant
9 characteristic during most of this period was the rapid growing
10 milk supply in the state (at an average increase of more than
11 four percent per year.) The need for additional plant capacity
12 to accommodate growing milk supply, led cooperatives and
13 proprietary processors to seek adjustments to the formulas to
14 keep them current the actual costs, product prices, and yields
15 so that plants could profitably transform dairy farmers' milk
16 into products that could be marketed to consumers who were
17 increasingly located a greater distance from the the state.

18 BY MR. ENGLISH:

19 Q. So how do these adjustments work and what impacts do
20 they have?

21 A. Well, often times, during that period there were lots
22 of volatility, say, in energy prices, and also just changing
23 structure of the plant base in the state in terms of the size
24 of plants, the age of plants, and there were cost surveys
25 conducted by CDFA that would determine, I guess, a weighted

1 average manufacturing cost for plants in their sample, and
2 these became an area of focus where CDFA would announce the
3 survey, industry would examine the results, and would, maybe
4 one or more parties would petition the Department for a change
5 in the pricing formula.

6 Q. How often were these surveys completed?

7 A. In more recent years, they have been done annually.
8 Going back earlier in the period that I'm discussing here, they
9 came out less than annually, not quite biannually, but every 18
10 months maybe.

11 Q. Turning to an issue of particular interest in this
12 proceeding. Did those surveys ever involve dry whey?

13 A. Yeah. For a brief period, in the 2000's, I think
14 beginning with, it was 2004, I believe, data, but it was
15 released by the Department in 2006. They had for maybe three
16 years they published a weighted average manufacturing cost for
17 dry whey.

18 Q. And did that continue?

19 A. No, that was discontinued when the number of plants
20 fell below the minimum required to continue reporting the
21 information.

22 Q. So the number of plants actually manufacturing dry whey
23 fell below three?

24 A. Fell below three, fell below two.

25 Q. Why don't you continue with your statement.

1 A. Okay.

2 Both industry and CDFA recognize that for end product
3 price formulas to generate milk prices that accurately
4 reflected the value of milk to the plants that were purchasing
5 it, manufacturing costs and yields must reflect current
6 manufacturing conditions in dairy product plants. Likewise,
7 the commodity price values utilized in the formulas must
8 reflect actual prices received, adjusted for the plant's
9 location. If these conditions were not met, then the end
10 product formulas would cease to have economic validity, and
11 would improperly value the milk in the various classes.

12 CDFA's Attempts to Properly Incorporate Skim Whey Value in the
13 Class 4b Formula. On January 1, 2000, USDA implemented end
14 product price formulas for establishing Class III and Class IV
15 prices under the FMMO's. The formula for Class III computed
16 the skim value of milk used to manufacture cheese from an end
17 product protein price formula.

18 JUDGE CLIFTON: Start again, please.

19 DR. SCHIEK: The formula for Class III computed the skim
20 value of milk used to manufacture cheese from an end product
21 price formula for protein based on cheese and butter commodity
22 values, and an end product price formula for other solids that
23 was based on the value of dry whey. Because the Federal
24 Class III formula now used the value of dry whey explicitly,
25 producer groups in California began to request that dry whey be

1 included in determining California Class 4b prices as well.

2 The request to add dry whey to the Class 1 formula was
3 heard at a hearing in 2001 and denied, but in 2003, in the
4 midst of a period of low producer -- should say milk prices.

5 JUDGE CLIFTON: Let's do insert that. Page 21, second
6 line, we'll insert between "producer" and "prices" the word
7 "milk." And would you read again from the beginning?

8 DR. SCHIEK: The request to add dry whey to the Class 1
9 formula was heard at a hearing in 2001 and denied, but in 2003,
10 in the midst of a period of low producer milk prices, CDFA
11 decided to incorporate dry whey into the Class 4b formula.
12 Prior to 2003, the Class 4b formula had calculated the price
13 used to make cheese (Class 4b) as the sum of an end product
14 formula for cheese and an end product formula for whey fat.
15 The whey fat end product formula was based on the price of
16 Grade B butter, which was assumed to represent the best use of
17 the whey cream from cheese making operations. In 1998, the
18 Grade B butter price was replaced with a Grade AA butter price
19 less an adjustment of ten cents per pound, an amount that
20 represented the historic price difference between Grade AA and
21 Grade B butter prices at the Chicago Mercantile Exchange (CME).
22 That change was made when the CME discontinued trading of
23 Grade A and Grade B butter.

24 The Class 4b formula resulting from the 2003 decision
25 (which also incorporated a floor for butter, nonfat dry milk,

1 and cheddar cheese block prices at the corresponding Commodity
2 Credit Corporation price support levels) added a dry whey end
3 product price formula to the existing ones for cheese and whey
4 fat. In the new formula, the dry way manufacturing cost
5 allowance (MCA) in the formula was set at \$0.17 cents per pound
6 of whey, and the dry whey yield was set at 5.8 pounds per
7 hundredweight of milk at the formula's assumed vat test. The
8 whey price series used --

9 JUDGE CLIFTON: We'll make that change. We're on page 21,
10 working up from the bottom of the page, six lines, the line
11 starts with the word "price" and then the next word is "series"
12 and the next word will be used. We'll strike an S and insert a
13 D. Thank you, Ms. Elliott.

14 DR. SCHIEK: The whey price series used was a simple
15 average of the weekly Dry Whey West Mostly price as reported by
16 the Agricultural Marketing Service (AMS) of the U.S. Department
17 of Agriculture (USDA) in the Dairy Market News between the 26th
18 of the prior month through the 25th of the current month.

19 BY MR. ENGLISH:

20 Q. So just couple of questions while we're there. What is
21 a "mostly" price? What is your understanding of a "mostly"
22 price?

23 A. In dairy, the Dairy Market News publication, prices are
24 surveyed and typically, there's a range reported. And next to
25 the sort of regular, I call it maybe the broader range, there's

1 what's called a "mostly" range. And that is to kind of narrow
2 in on where most of the survey priced transactions are priced,
3 as opposed to there maybe some that are, it is just one or a
4 couple of observations that are at the extreme. So the mostly
5 is more of a central tendency, it's not really an average, per
6 se, but it is a central tendency in the data that occurs when
7 USDA's dairy division staff in Madison, Wisconsin, working at
8 Dairy Market News, surveys the plants for these prices.

9 Q. Just to be clear, since there's been discussions of
10 other surveys, such as the mandatory Dairy Product Price
11 survey, how is this survey -- how is this survey conducted,
12 very briefly?

13 A. Yeah. My understanding is from talking with folks
14 there, it's a telephone, it's a survey where they contact
15 individuals who market these products and they get a range of
16 prices based on responses. I don't believe it is audited as
17 the NDPSR data is. That's my that's my impression.

18 Q. All right. Why don't you continue with your statement.

19 A. In 2005, CDFA held another hearing to consider changes
20 to all manufacturing class formulas, including the Class 4b
21 formula. As a result of the testimony and evidence given, the
22 Hearing Panel recommended that the Secretary remove the dry
23 whey portion of the Class 4b formula. The Secretary rejected
24 that recommendation and instead, increased the MCA to \$0.20
25 cents per pound. In 2006, CDFA held another hearing to

1 consider changes to the 4a and Class 4b formulas. Again, the
2 Hearing Panel recommended that the dry whey portion of the
3 formula be removed, and again, that recommendation was not
4 adopted by the Secretary, but the dry whey MCA was increased to
5 \$0.267 cents per pound. The MCA level was equal -- that MCA
6 level was equal to the weighted average manufacturing cost in
7 2004 of the California plants making dry whey according to what
8 was then a new cost survey conducted by CDFA. Prior to 2006,
9 CDFA did not have any California based manufacturing costs upon
10 which to base a dry whey MCA.

11 In 2007, dry whey prices spiked to unprecedented
12 levels, topping \$0.80 cents per pound on a weekly basis in the
13 early summer, and California cheese makers began to experience
14 compressed margins and financial losses. In August of that
15 year, a group of eight cheese makers petitioned CDFA for a
16 hearing to consider removing the dry whey end product formula
17 from the Class 4b milk price formula. Producer groups opposed
18 removing the dry whey factor from the formula. In its November
19 2007 report, the Hearing Panel said the following about trying
20 to incorporate a value for skim whey in a cheese milk formula:

21 Now I'm quoting from the Hearing Panel report from
22 November of 2007:

23 "The current whey factor in the Class 4b pricing formula that
24 uses a dry whey specific price, MCA, and yield, is non
25 sustainable:

1 *the current formula is in itself, flawed:

- 2 - the yield is not representative of what processors
3 testify to as their actual plant yields,
4 - the price is not representative of prices received by
5 California cheese plants for dry forms of whey,
6 - the MCA is based on actual cost for dry whey plants
7 in California, but these costs are high because most
8 large cheese plants with potential economies of scale
9 do not make dry whey.

10 *most plants do not process wet-skimmed whey into a dry form of
11 whey,

12 *those plants making a dry form, do not make dry whey.

13 Those plants making a dry form of whey, do not make a standard
14 product, or set of products. Thus, it is not possible to
15 develop a new factor using an alternative dry form of whey with
16 its own price, manufacturing cost, and yield..."

17 JUDGE CLIFTON: Manufacturing cost?

18 DR. SCHIEK: Manufacturing cost allowance and yield.

19 And then I'm skipping a little, and pick up.

20 "...some small and medium-volume cheese processors are able to
21 sell their wet-skimmed whey to producers as animal feed. The
22 panel believes that there is a value for wet-skimmed whey that
23 strikes a balance among those cheese processors making a form
24 of dry whey, those processors selling wet-skimmed whey of
25 animal feed, and those processors with no market opportunity

1 for their wet-skimmed whey.
2 After carefully weighing all the relevant economic factors, the
3 panel believes that ten cents per hundredweight as the fixed
4 whey factor, is an appropriate figure. Replacing the highly
5 volatile whey factor with a fixed value would provide constant
6 value to producers. It would limit the negative impact on
7 producers of highly volatile whey prices. It would help to
8 avoid the negative consequences that impact small -- impacted
9 small and medium-volume cheese processors during 2007."

10 JUDGE CLIFTON: Now, I want you to go back to the paragraph
11 above that in your quoted material, and you see the phrase
12 second or third line up in that paragraph above where you just
13 finished. And you will see, "among those cheese processors
14 making a dry form of whey," if you read that, making, or excuse
15 me, "those cheese processors making a form of dry whey" would,
16 does that mean the same?

17 DR. SCHIEK: No, I think the way it is written is what it
18 is supposed to mean. A dry form of whey, which could be whey
19 protein concentrate, whey protein isolate, dry whey, could be a
20 number of products.

21 JUDGE CLIFTON: Ah, all right. Well, you didn't read it as
22 written.

23 DR. SCHIEK: Okay.

24 JUDGE CLIFTON: So -- so the way it is written really is
25 the precise meaning?

1 DR. SCHIEK: It is.

2 JUDGE CLIFTON: All right. So would you please take that
3 sentence and just read that again, beginning with "the panel."

4 DR. SCHIEK: "The panel believes there is a value for
5 wet-skimmed whey that strikes a balance among those cheese
6 processors making a dry form of whey, those processors selling
7 wet-skimmed whey as animal feed, and those processors with no
8 market opportunity for their wet-skimmed whey."

9 JUDGE CLIFTON: Thank you.

10 DR. SCHIEK: Picking up:

11 The Hearing Panel reported further -- the Hearing Panel
12 report further noted that the proposed change to a fixed whey,
13 fixed value whey factor would increase the spread between the
14 Class 4b price and the Federal Class III price.

15 JUDGE CLIFTON: Let's go off the record for a moment.

16 (Whereupon, a short break was taken.)

17 JUDGE CLIFTON: All right. We can go back on record at
18 3:47. We're on page 23.

19 DR. SCHIEK: The Hearing Panel report further noted that
20 the proposed change to a fixed value whey factor would increase
21 the spread between the Class 4b price and the Federal Class III
22 price. Against a backdrop of milk supplies that were straining
23 plant capacity in the state, the panel noted the need for Class
24 4a and Class 4b prices to be market clearing, and stated:
25 "...remember, however, that the California minimum price is a

1 market clearing price, while the Federal Order price is not.
2 The fact that cheese processors that operate under the Federal
3 Order may avoid the responsibility of paying the Federal Order
4 minimum price is sufficient reason to justify the increasing
5 spread between Class 4b and Class III prices.

6 In this context, the panel, is using the term
7 "market-clearing price" to mean the price at which supply
8 equals demand. At that price, the sellers are willing to
9 supply exactly the quantity of goods that the buyers are
10 willing to purchase. In the dairy industry, the market
11 clearing price is the price at which processors are willing to
12 buy all the milk that producers are willing to sell. In the
13 situation under the California regulated system of classified
14 pricing, the minimum 4a/4b prices must be low enough so that
15 manufacturing plants are willing to buy all the milk that is
16 not used in Classes 1, 2, and 3."

17 The CDFA Secretary modified this decision to make the
18 fixed whey factor \$0.25 cents per hundredweight, rather than
19 the \$0.10 cent value that the Hearing Panel recommended, but
20 the dry whey end product formula was eliminated from the
21 calculation of the Class 4b price. As a result of a subsequent
22 hearing decision made effective in September 2011 the fixed
23 whey factor evolved into a whey contribution schedule (sliding
24 scale) which was amended further in August 2012. Most
25 recently, the whey contribution schedule was adjusted upward

1 for one year from August 2015 through July 2016. A summary of
2 the history of the "dry whey factor" in the Class 4b formula
3 illustrating the major changes made through mid-2013 is
4 contained in Figure 1.

5 BY MR. ENGLISH:

6 Q. And that is Figure 1 on Exhibit 80, correct?

7 A. It is.

8 Q. So we finally get to Exhibit 80, your Honor, which,
9 with a cover, there's a cover page and then there are 31
10 figures and tables. So what Dr. Schiek has just referred to is
11 page 1, and it's labeled Figure 1 on the lower left hand
12 corner, how you get perspective. So why don't you tell us what
13 this chart is and how you produced it. Well, first of all, did
14 you produce this chart, Dr. Schiek?

15 A. I did.

16 Q. So why don't you tell us a little bit about what this
17 chart does and shows?

18 A. The chart tracks the dry whey contribution value in the
19 Federal Milk Marketing Order.

20 Q. Is that the dark blue line?

21 A. That's the dark blue line with the dark blue --

22 Q. Solid?

23 A. Solid.

24 Q. Diamonds or --

25 A. Yeah, diamonds. And then there's a lighter blue line

1 that represents the California formula whey contribution to the
2 Class 4b price. So we have got the Federal whey value formula
3 to the Federal Order Class III price with the darker line, and
4 the lighter line is the California whey value contribution.
5 And then the chart is annotated with the Hearing Panel reports
6 and decisions made at various key moments since the inception
7 of the formula.

8 Q. All right. Anything you want to add about that figure
9 at this point?

10 A. I think what was happening in 2007 that led to that
11 hearing is somewhat obvious in the chart. Where, you know, the
12 contribution value, both in the Federal Order pricing and in
13 California 4(b) pricing, reached levels that were much higher
14 than anything that had been historically experienced. And so I
15 think it illustrates where class -- where cheese makers that
16 don't have whey processing capabilities saw their margins
17 compressed. And it's -- it was after that hearing at the end
18 of 2007 when the fixed whey factor was put in place, and you
19 kind of see that where the light blue line flattens out.

20 And then in 2011, you see where the price moves higher
21 and then it's flat some of the time, but it does go up and down
22 a bit, and that's where the whey sliding scale was introduced.
23 So initially, when the fixed factor was put in, you can see
24 where the, it actually was contributing more than the Federal
25 formula for a period of time, because whey prices were, they

1 went from very high levels to very low levels. And that
2 sometimes happens in the dairy market. But typically when
3 things go really high, they become really low later on. But
4 eventually recovered. And it is that difference between the
5 dark blue line and the light blue line that I think pretty much
6 explains why we're here.

7 JUDGE CLIFTON: Dr. Schiek, what's the difference between
8 what is measured by the Federal Order when it refers to a whey
9 value, and the California system when it refers to a whey
10 value, or when you, on this chart, refer to whey value? Now,
11 you have given us the history in California, we know it
12 changed, it kept changing. But as I look at this chart, I need
13 to understand how what is being measured may differ.

14 DR. SCHIEK: Okay. So what's being measured here when we
15 say whey value. We're not talking specifically about the whey
16 price. What we're talking about is the contribution that, for
17 any given whey price, that that formula that's operative either
18 in the Federal Order or in California, makes to the cheese milk
19 price in California that would be 4b, and in Federal Orders
20 that would be Class III. So it is really a whey contribution
21 to the milk price of those classes for Class III and Class 4b.

22 JUDGE CLIFTON: So it's extremely valuable because it gets
23 right to the value back to the producer? The value back to the
24 handler?

25 DR. SCHIEK: Yes, it gets to the value that the handler,

1 the price the handler pays, and the price that enters the pool
2 either in California or under the Federal Orders, and goes into
3 the calculation of producer uniform prices, and quota, and
4 overbase prices here in California.

5 BY MR. ENGLISH:

6 Q. Anything else on Figure 1 or should we continue with
7 your statement?

8 A. I think we can continue.

9 JUDGE CLIFTON: So we're now on page 24?

10 MR. ENGLISH: You are on 24, and Dr. Schiek and I are on
11 the bottom of 26.

12 JUDGE CLIFTON: All right. And we're starting, I believe,
13 with "it is ironic"; is that correct?

14 MR. ENGLISH: Yes.

15 DR. SCHIEK: It is ironic that the very issue that dairy
16 farmer cooperatives are now attempting to overturn through
17 their petition for a California Federal Milk Marketing Order
18 was adopted by CDFA to restore orderly marketing in the state
19 by changing milk pricing formulas so that milk markets would
20 clear by allowing for a regulated price at which cheese plants
21 could profitably operate. It illustrates that what the
22 petitioners are primarily concerned with is getting a higher
23 regulated price (one that is set above market clearing levels)
24 and not ensuring orderly marketing, which has been CDFA's
25 stated chief concern since the early days of state milk pricing

1 regulation in California.

2 In summary, the foregoing review makes it clear that
3 CDFA has a long -- has a history of being responsive to changes
4 in the marketplace and making needed changes in accordance with
5 legislative directives. The state is still responsive to the
6 need to maintain orderly marketing and an adequate supply of
7 milk for consumers. For much of the last several years, CDFA
8 has not made the specific changes producer groups have
9 requested, which have to do with their desire to be paid more
10 for their milk rather than solving any particular problem of
11 disorderly marketing. California's dairy farmers' desire for a
12 higher price is the fundamental reason why we're gathered at
13 that hearing. More specifically, the state's dairy farmer
14 cooperatives want higher regulated prices so the cheese makers
15 will be required to pay more for milk and so that more of the
16 money currently being paid by a few proprietary cheese
17 manufacturers to dairy farmers as premiums to attract the kind
18 of milk supply that is valuable to them gets contributed to all
19 producers through the pool.

20 Unfortunately, in their quest for higher milk prices,
21 the question of what is an appropriate market clearing price
22 for milk used to make manufactured products, specifically
23 cheese, gets ignored in both their proposal and their
24 arguments; so does CDFA's history of making hearing decisions
25 specifically directed at maintaining orderly marketing in the

1 state and setting prices at levels which are market clearing.

2 II. CURRENT MILK MARKETING CONDITIONS IN CALIFORNIA ARE
3 ORDERLY.

4 USDA has stated that FMMO's objectives are to: "Assist
5 farmers in developing steady dependable markets by providing
6 prices for their milk which are reasonable in relation to
7 economic conditions" and to "assure consumers that at all times
8 of adequate supplies of pure and wholesome milk at reasonable
9 prices." (See end note (x) on page 40 of Exhibit 79.) In its
10 publication from 1989 entitled, Questions and Answers on
11 Federal Milk Marketing Orders, USDA notes that, "Federal Orders
12 are primarily instruments for stabilizing marketing conditions
13 for fluid milk." It accomplishes these objectives by setting
14 minimum prices for various classes of milk, establishing
15 pooling provisions to provide for uniform prices to producers,
16 providing market information to the industry in general and
17 dairy farmers specifically, ensuring accurate weights and tests
18 for producer milk, and auditing handler records to ensure that
19 they have properly accounted to the pool and paid producers.
20 Because of the FMMO system's focus on Class 1 milk (fluid
21 milk), orderly marketing is primarily concerned with ensuring
22 that adequate supplies of fluid Grade A milk are available and
23 that milk moves to Class 1 use where it is needed, when it is
24 needed, and in an orderly fashion, so as to provide reasonable
25 returns to dairy farmers so that consumers have access to

1 adequate supplies of milk for fluid use, and that should say,
2 at reasonable prices.

3 JUDGE CLIFTON: All right. So we'll make that correction,
4 Ms. Elliott, on page 26, the second line. We'll add a word
5 that needs to be at the end of that sentence, "prices."

6 MS. ELLIOTT: Okay.

7 DR. SCHIEK: Current Differences Between California
8 Class 4a/4b Prices and FMMO Class III/IV Prices are not
9 Disorderly. It is no secret that regulated price levels under
10 California's State Order are different than FMMO price levels
11 for corresponding classes. We freely acknowledge these
12 differences, but disagree with the dairy farmer organizations
13 over their implications. While the cooperatives argue that the
14 differences in and of themselves amount to disorderly
15 marketing, we maintain that the difference exist -- strike the
16 word "is".

17 JUDGE CLIFTON: All right. Let us go to page 26, and we're
18 in the first full paragraph, under the heading "current
19 differences." And next to the last sentence of that paragraph
20 has the word "is" that we'll just strike.

21 DR. SCHIEK: While the cooperatives argue that the
22 differences in and of themselves amount to disorderly
23 marketing, we maintain that the differences exist to promote
24 and maintain orderly marketing -- gosh, double orderly
25 marketing -- in the state.

1 JUDGE CLIFTON: So, Ms. Elliott, same line, we'll just
2 strike one set of the words "orderly marketing." And go ahead
3 and read that sentence one more time if you would, Dr. Schiek.

4 DR. SCHIEK: While the cooperatives argue that the
5 differences, in and of themselves, amount to disorderly
6 marketing, we maintain that the differences exist to promote
7 and maintain orderly marketing in the state.

8 Regulated price differences between different regions
9 or different markets are neither a necessary, nor a sufficient
10 condition for disorderly marketing. While price differences
11 can be an indicator of the potential for disorderly marketing
12 conditions, they are by no means evidence that conditions are
13 disorderly. We have seen no substantive evidence that current
14 marketing conditions are disorderly. However, this issue of
15 manufacturing class prices being at levels that were not market
16 clearing, has been a concern.

17 JUDGE CLIFTON: So Ms. Elliott, you see where we are, we're
18 just striking a D. Thank you.

19 MS. ELLIOTT: Is it "ED"?

20 JUDGE CLIFTON: Pardon?

21 MS. ELLIOTT: Is it "ED?"

22 MR. ENGLISH: There's an extra ED.

23 JUDGE CLIFTON: Oh, yes, you are right.

24 DR. SCHIEK: And then strike the rest of that sentence.

25 JUDGE CLIFTON: Truly? Yes?

1 DR. SCHIEK: Yes.

2 JUDGE CLIFTON: Okay. Walk us through it, Dr. Schiek.

3 DR. SCHIEK: The sentence should just read: "However, this
4 issue of manufacturing class prices being at levels that were
5 not market clearing has been a concern."

6 JUDGE CLIFTON: All right. So we'll strike the ED, we put
7 a period, and then truly, we strike all the rest of that?

8 DR. SCHIEK: Yeah, that was -- that was deleted text that
9 somehow got undeleted.

10 MR. ENGLISH: Like I said, Mr. Beshore's gremlins are
11 contagious.

12 JUDGE CLIFTON: All right. So that paragraph then, will
13 end with the word concern, period.

14 DR. SCHIEK: Uh-huh

15 JUDGE CLIFTON: All right.

16 DR. SCHIEK: While it is certainly crucial for regulated
17 manufacturing class milk prices to be market clearing under
18 FMMO's, the negative consequences that ensue are exacerbated
19 under a system of pricing like the one in California where
20 virtually all milk is required to be paid minimum prices.

21 JUDGE CLIFTON: All right. So I saw two changes. The
22 first one I saw, Dr. Schiek, is in the second line of that
23 paragraph where at the bottom of page 26 it's a partial
24 paragraph, and you said "under a system," so we're striking the
25 word "of" and inserting "a"?

1 DR. SCHIEK: Yes, it should say "a".

2 JUDGE CLIFTON: "Under a system." And then on the next
3 line we're striking the word "were" and inserting the word
4 "where." Is that correct?

5 DR. SCHIEK: Correct.

6 MS. ELLIOTT: What was the second one?

7 JUDGE CLIFTON: It is on the next to the last line, after
8 the word California there's a word "were" that should be
9 "where." And then Dr. Schiek, would you begin from the
10 beginning of that sentence, please?

11 DR. SCHIEK: While it is certainly crucial for regulated
12 manufacturing class milk prices to be market clearing under
13 FMMO's, the negative consequences that ensue are exacerbated
14 under a system of pricing like the one in California, where
15 virtually all milk is required to be paid at minimum prices.
16 There is no safety valve to clear excess milk from the market
17 under CSO pricing, and would be none under any system of
18 mandatory pooling. The only way to ensure that regulated
19 manufacturing class milk prices will not be at levels that
20 create disorderly marketing conditions, is to make really
21 certain that the regulated price levels are market clearing in
22 the local market.

23 MR. ENGLISH: I think you just inserted the word
24 "marketing" between the word "disorderly" and "conditions" in
25 that sentence, correct?

1 DR. SCHIEK: Actually, I don't know why I inserted it.
2 Disorderly conditions, so you can put marketing if you want.

3 BY MR. ENGLISH:

4 Q. Is it acceptable the way it is text?

5 A. I think it is acceptable the way it is.

6 JUDGE CLIFTON: Okay. Before going on, I really want to
7 understand this paragraph.

8 So what's the difference between the way most Federal
9 Milk Marketing Orders would operate to clear some milk that
10 would not work in California?

11 DR. SCHIEK: Okay. So in Federal Orders, milk that is a
12 transaction between a pool handler and a nonpool plant, there
13 is no application or enforcement by USDA on the nonpool plant
14 purchase price, the price that the plant buys the milk from the
15 pool handler. So let's say a pool handler has excess milk and
16 they want to clear it from the market. They are able to keep
17 the milk pooled and they will report to the pool at that price,
18 but the actual plant that takes the milk and makes a physical
19 product out of it, that's an unregulated transaction. Okay?

20 In California, the only way that could possibly happen
21 is between a proprietary plant that might have some extra milk,
22 and a proprietary manufacturing plant or co-op that's buying
23 that milk. So if say a bottler had excess milk and wanted to
24 sell to a co-op or to a proprietary manufacturing plant, they
25 could, that transaction could be unregulated in terms of price

1 level. But, let's face it, the bulk of the milk, the
2 California is bulk marketed by cooperatives, and it is illegal,
3 not possible, for any other proprietary plant to pay less than
4 the minimum price for that milk offered to them by a
5 cooperative, because the cooperative is a producer, and they
6 can't pay producers less than the regulated minimum price.

7 So there's just not a same ability to clear markets
8 when, at least to clear them locally in California, when
9 there's too much milk. When that situation arises, the option
10 is to truck the milk out-of-state. And there's not a lot of
11 manufacturing plants in Nevada. There's one opened recently.
12 But, you know, when problems aren't, there isn't too much
13 excess milk that that product is flowed to Arizona, for
14 example, but we have lots of reports at times of heavy surplus
15 that it is ended up in Idaho, in New Mexico, in Texas, and even
16 places more distant than that in concentrated forms.

17 BY MR. ENGLISH:

18 Q. And is that, in your opinion as an Economist, because
19 of the structure of pricing in California?

20 A. It is because of the structure of pricing and pooling.

21 Q. Pricing and pooling.

22 A. In California. Of course, another option, so what I
23 described in the Federal Order is how to clear excess milk
24 that's commonly known as a diversion to a nonpool plant. So
25 the milk, in that situation, the milk is still pooled, but the

1 ultimate buyer of the milk isn't bound by the regulated price.
2 So they can pay, if the surplus conditions are really heavy,
3 they could pay dollars under the class price, regulated class
4 price, for that milk. It is whatever the market will bear in
5 that situation.

6 The other potential for clearing excess milk is simply
7 to depool the milk. And again, whatever the market will bear.

8 Q. That's in the Federal Order?

9 A. In the Federal Order, but not in California. Because
10 if you can depool milk, you can operate as a nonpool plant, but
11 you are still obligated at the minimum prices.

12 Q. Just to be clear, Dr. Schiek, have you seen this year
13 in parts of the Upper Midwest or Mideast and Northeast, reports
14 of that exactly happening, milk being sold at multiple dollars
15 below class because of the volumes being in excess of what
16 people could make and get a profit for?

17 A. I have seen those reports in Dairy Market News, yes.

18 Q. Okay. Your Honor, could we have a five-minute stretch
19 break?

20 JUDGE CLIFTON: It's now 4:13. We'll take roughly ten
21 minutes plus 2, so please be back and ready to go at 4:25.

22 (Whereupon, a break was taken.)

23 JUDGE CLIFTON: We're back on record now at 4:26,
24 Mr. English.

25 MR. ENGLISH: Yes, your Honor, thank you very much, both

1 for those questions and for the break.

2 BY MR. ENGLISH:

3 Q. I believe for purposes of the version that everyone
4 has, other than Dr. Schiek and myself, we are on page 27 of the
5 first full paragraph that starts "we maintain". So, Dr.
6 Schiek, if you wish to continue at that point.

7 A. We maintain that the current FMMO prices for Class III
8 and Class IV are not market clearing for California. There is
9 evidence that in the recent past, California's Class 4a and 4b
10 prices have been set at levels that were not market clearing,
11 despite those prices being below corresponding FMMO prices.
12 While it has been accurately stated that the market for
13 manufactured dairy products such as cheese, nonfat dry milk,
14 whey and butter, are national (and increasingly global)
15 markets, and that market clearing prices for these products are
16 determined by the national balance of supply and demand, the
17 statement does not go far enough. The national market clearing
18 price manifests itself as a surface of regional dairy product
19 prices that vary by location. This result is derived from a
20 fundamental economic concept of spatial equilibrium that is at
21 work in all commodity markets that have positive transfer costs
22 across space.

23 Q. You used a phrase like "spatial equilibrium" with a
24 bunch of lawyers in the room. Would you please explain what
25 that last sentence means and what spatial equilibrium is.

1 A. Well, market equilibrium, in general, is right, it is
2 where supply and demand equate. That's known as an equilibrium
3 point. When we look at a basic economic diagram we have just
4 one supply curve and one demand curve. But in, you know, in
5 reality what you have is supply curves in different regions,
6 and demand curves in different regions. And product can move
7 from one location to another. And eventually, based on
8 differences in supply and demand, costs of moving product,
9 there is an equilibrium point. And what is often the result of
10 that equilibrium, is you have different prices across space.

11 And when I talk about positive transfer costs, what I
12 mean is, it costs something to move product from one point to
13 another. From one state to another, from one city to another.
14 Those are positive transfer costs. If you assume there were
15 no, if product just magically disappeared and reappeared
16 somewhere else, then you could have the same price in different
17 cities. And there are occasions in spatial equilibrium, where
18 even with positive transfer costs, some cities may have the
19 same price because that just may be the equilibrium point for
20 those products. But, in general, there will be variations
21 across space. That's why corn prices are cheaper in Iowa than
22 they are in Florida, for example. And you could look at any
23 commodity, you will find that sometimes spatial price
24 difference exists.

25 Q. Okay. Continue.

1 A. Distance to market matters. It is no secret that there
2 are more people living in the Eastern half of the country than
3 in the Western half. Therefore, the largest market for
4 finished dairy products, particularly cheese and butter, is
5 located in the eastern half. The production of manufactured
6 dairy products has grown in the Western half the country to the
7 point where those products must leave the region in order to
8 find a market. This disparity between where products are
9 produced and where they are consumed, creates a spatial value
10 that is lower in the West and higher in the East. If regulated
11 milk pricing formulas failed to account for differences in
12 spatial value of finished products (and to account for current
13 yields and current costs of manufacturing dairy products from
14 milk) the milk will not be properly valued.

15 Q. I think you skipped -- I am getting there, your Honor,
16 but I'm trying to get ahead of you.

17 I think you omitted the word "dairy" between "finished"
18 and "products" in the line up from the there.

19 A. I did, and it was supposed to be there.

20 Q. Okay.

21 JUDGE CLIFTON: So it wouldn't hurt to read that sentence
22 again.

23 DR. SCHIEK: Okay.

24 If regulated milk pricing formulas failed to account
25 for differences in spatial value of finished dairy products,

1 and to account for current yields and current costs of
2 manufacturing dairy products for milk, the milk will not be
3 properly valued.

4 BY MR. ENGLISH:

5 Q. Now, let's also go back in for a different reason, into
6 that paragraph. And you reference "the production of
7 manufactured dairy products has grown in the Western half of
8 the country." Has that growth increased, accelerated, changed,
9 since Federal Order Reform?

10 A. I think that growth was occurring before Federal Order
11 Reform, but yeah, it has -- it has accelerated, I believe,
12 since Federal Order Reform, because not only has it grown in
13 California, but it's grown in places like Idaho, Colorado,
14 New Mexico, Texas, Western Texas specifically, so, yeah. I
15 believe it has accelerated.

16 Q. All right. So continue with the next paragraph that
17 starts "in considering"?

18 A. In considering what it means for regulated milk prices
19 to be market clearing, we have to look beyond the balance of a
20 supply and demand of finished dairy products in the national
21 marketplace and focus clearly on what is happening in the
22 local, i.e., (state or region) market for milk. The markets
23 for finished products clear nationally, but --

24 JUDGE CLIFTON: Go ahead and start again.

25 DR. SCHIEK: The markets for finished dairy products clear

1 nationally, but the market for milk clears locally. If there
2 is excess cheese in one region of the country, it can be
3 marketed on a Chicago Mercantile Exchange, which serves a
4 national market clearing function, although even in those
5 transactions, the price is adjusted based on location of the
6 seller. If there is excess milk in a particular region, it
7 cannot be hauled across the country to be sold, or all of its
8 value will be eaten way by the transportation cost associated
9 with shipping it to its destination. Therefore, in order for
10 marketing to be orderly and efficient, milk needs to clear the
11 market by finding a plant within reasonable distance from where
12 it is produced. If it cannot, then it will either be dumped or
13 hauled long distances at great expense to find a home.

14 This was the situation that faced California on
15 numerous occasions beginning in 2006, although it is my
16 understanding that similar conditions were seen in California
17 in the mid-1980's when milk production was growing faster than
18 plant capacity in the state. In Figure 2 and Table 1, I have
19 charted an estimate of plant capacity in California against the
20 state's milk production.

21 Q. So, again, this is Exhibit 80, and Figure 2 is page 2,
22 and Table 1 would be on pages 3, 4, and 5, correct?

23 A. Correct.

24 Q. And so why don't you finish what you are saying. I'll
25 ask you some questions, but go ahead and continue after milk

1 production. So you begin with 2006, 2008 period?

2 A. In the 2006 to 2008 period, there were as many as 19
3 months when milk production in the state exceeded willing
4 capacity necessitating movements of milk to out-of-state plants
5 located in states as distant as Idaho, Texas, and New Mexico.
6 From the second half of 2008 until 2012, plant capacity was in
7 excess after a decline in milk output, the opening of new
8 plants, and the expansion of others. But by early 2012, milk
9 production was outpacing plant capacity again, and one
10 cooperative had to take some rather dramatic steps to reduce
11 its incoming milk supply. Milk production exceeded plant
12 capacity once again in 2014.

13 JUDGE CLIFTON: Let me stop you and we'll make that
14 correction. Ms. Elliott, we're at the bottom of page 28, the
15 last line, we're going to strike the "was" which is the second
16 word.

17 MS. ELLIOTT: Okay.

18 JUDGE CLIFTON: And Dr. Schiek, if you would read that
19 sentence again.

20 DR. SCHIEK: Sure.

21 Milk production exceeded plant capacity once again in
22 2014. Milk production has been lower in 2015, but it remains
23 to be seen whether this one-year decline from an all-time high
24 in the state's milk output is a trend. Milk output has
25 declined previously in the state, only to reach new record

1 production levels in subsequent years.

2 BY MR. ENGLISH:

3 Q. So let me stop you and let's look at Figure 2 and Table
4 with 1 of Exhibit 80. Does it make sense to talk about the
5 table first and then the figure or --

6 A. Yeah, let's talk about the table first, because the
7 table has the numbers behind the figure, and I want to explain
8 a little bit about how I prepared this table so that people
9 understand what I have done.

10 First off, there is no publicly available evidence of
11 actual plant capacities in the state. So in trying to estimate
12 what willing capacity was, and what I mean by willing capacity,
13 is capacity that the owners and operators of plants are willing
14 to make available. It may be possible for a plant to
15 physically produce more product and take in more milk by adding
16 a third shift, incurring extra costs, but at least this is an
17 example, I think, of the willing capacity at given prices.

18 Q. So would a limited on willing plant capacity, by
19 example, be Class 1?

20 A. Class 1 would be a good example of that, because, you
21 know, we have seen Class 1 sales decline, and I'll obviously
22 get into that in a little bit later as well, but it's
23 reasonable to expect there's some excess plant capacity in
24 Class 1. But, you know, if you are trying to market milk and
25 getting a Class 1 plant to make a product they can't sell is

1 not likely to be a, they are not likely to be willing to do
2 that, even though they may physically have the room in their
3 plant.

4 Q. All right. So that's an example of limitation on
5 willing plant capacity that you considered?

6 A. Yes.

7 Q. Okay. So continue with what you did here and how you
8 did it.

9 A. So as we talked about how Dairy Market News reports
10 certain happenings in the fluid milk market. In this past year
11 they reported milk selling below class in the Midwest, they
12 report milk being dumped in Michigan, I think. They have also
13 reported milk moving out of the state in California and milk
14 not being marketed on occasion in California or milk being
15 dumped.

16 So when we -- we had a period where milk production was
17 growing rapidly in California prior to 2006, but also new
18 plants were being built. And those new plants were coming
19 online in the early part of the 2000's, and there was adequate
20 room to grow and adequate capacity. But by 2006, that growth
21 in additional plant capacity had been slowing down and
22 basically coming to a halt for couple of years, but milk
23 production kept growing.

24 So in early 2006, in March and April, first began
25 noticing USDA Dairy Market News reporting milk leaving the

1 state to find a processing home. And we had a hearing, I think
2 it was in 2006, in June, on Class 4a and 4b prices, and then
3 CEO of CDI, Richard Cotta, C-O-T-T-A, was testifying and talked
4 about marketing conditions in the state. So that seemed to be
5 a time, looking at how much average daily production was and
6 the fact that some milk was moving out-of-state at that time, I
7 kind of developed a basic point in early 2006 that the maximum
8 average daily capacity was around 110 million pounds. Because
9 you will see during the month of March and April, months that I
10 believe USDA, looking back, reported milk leaving the state, we
11 were just a bit above 110 million pounds on a daily basis.

12 Q. Whereas, in the month of February and May, the average
13 daily production was less than the 110 and that wasn't
14 reported; is that correct?

15 A. That's correct. And after that time I was trying to
16 keep track of announcements of plant openings, additions,
17 capacity, closings, based on press releases, reports in
18 newspapers, and those kinds of things.

19 Q. Let me be clear, did you actually start sort of
20 creating this back in 2006?

21 A. Yes.

22 Q. So this wasn't created for this particular proceeding?

23 A. No.

24 Q. Okay. So this was something you were doing as part of
25 your job in the Dairy Institute of California, observing the

1 economic conditions in the marketplace, correct?

2 A. Right.

3 Q. So go on.

4 A. So -- so again, making adjustments to the effect of
5 plant capacity, you can see that I had it pegged at 110 million
6 pounds in 2006. And then going forward, you know, I didn't
7 notice, didn't have any reports of plant closures or plant
8 openings. So, you know, it didn't change.

9 Again, there's no publicly available source of data for
10 this, so I'm just trying to track it on my own by looking at
11 the market information that's out there. And then you see the
12 first change was an announcement that Golden Cheese Plant,
13 Golden Cheese in Southern California in Corona, was going to
14 reduce, in September, the amount of milk that was coming into
15 the plant, and then later in the year, you can see also they
16 closed the plant, now --

17 JUDGE CLIFTON: Now, that was September of what year?

18 DR. SCHIEK: 2007.

19 BY MR. ENGLISH:

20 Q. Did they -- where did you come up with the 3 million
21 pounds? Was that --

22 A. So here's the, where there may be some difference in
23 terms of what folks who operate the plants, they will say,
24 "Well, you have got 3 million pounds here and 2 million pounds
25 there, and we were only running maybe four million, four and a

1 half million, so we didn't really lose five million." Five
2 million was just the number in the industry that we were
3 originally told, it is sort of the common knowledge of the
4 industry, that the capacity of that plant when it opened was
5 five million pounds. Now, sometimes announced capacity and
6 actual capacity could be different, so there could be some
7 differences in these numbers, I'll freely admit that. This is
8 just my best attempt to track plant capacity in the state.

9 Q. Okay. So you say what happened was Golden Cheese first
10 cut back, then it closed. You are also showing another entity,
11 what, Provision Foods?

12 A. Right. Provision Foods purchased a plant that Kraft
13 Foods had basically sold, they consolidated their operations
14 into a different plant, and so there was a plant available,
15 this company, Provisions Foods, bought and operated the plant,
16 and had the capacity of roughly a million pounds of milk a day.
17 They were, initially when they started, they were running an
18 old dryer and buying milk from others who had surplus milk to
19 sale.

20 Q. So then it looks like the same time Golden Cheese
21 closed completely, DFA Hughson nonetheless added plant
22 capacity; is that correct?

23 JUDGE CLIFTON: Your voice dropped off.

24 MR. ENGLISH: And the court reporter has mentioned that a
25 number of times, and I keep trying not to have it happen.

1 JUDGE CLIFTON: So when you said, Hughson, say again what
2 you said before you said "right?"

3 BY MR. ENGLISH:

4 Q. Well, what I was trying to get at was that it looks
5 like Golden Cheese closed, if not simultaneously, certainly
6 during the same month that DFA Hughson added volume. So the
7 net effect was one million pounds, because you lost two million
8 pounds OF Golden Cheese, but picked up one million pounds of
9 DFA Hughson; is that correct? That's why you dropped only one
10 million, from 108 to 107?

11 A. Right. We are keeping track of net effects here, for
12 the most part, so we have, you know, we had Provisions Foods
13 adding, we had DFA Hughson adding or expanding, or making
14 changes to increase the surplus in their plant, and then we had
15 the closure of Golden all around the same time.

16 Q. Okay.

17 A. And then the big change that occurred that year was,
18 CDI added their first Visalia plant around that same time.

19 Q. So if you track through the rest the notes on the right
20 hand column, that explains your changes in which such changes
21 occur, for daily affects of California plant capacity, which is
22 the last column of numbers, correct?

23 A. That's correct. And so that is -- that is one number
24 that's on Figure 2. That's the red, I think in the graph it is
25 the red line that has long solid sections where it doesn't

1 change, and then it kind of moves in step-wise fashion.

2 Q. Okay.

3 A. The blue line, so that's the average daily maximum
4 effective or willing plant capacity. And then the blue line is
5 the average daily milk production. And that's computed by
6 using data from USDA's Milk Production Report for California,
7 and dividing by the number of days in the month. So you can
8 see from the graph, that there were periods in, you know,
9 starting in 2006, at the very beginning couple of months, there
10 where the, I guess I should have made the line thinner, but a
11 couple of months where the production piqued above that
12 ceiling, and then a significant period in 2007, 2008, then a
13 long period where capacity was more than sufficient for a
14 production, because in the wake of 2009 financial collapse, the
15 dairy market prices, commodity prices fell, and milk prices
16 fell, and so production in California contracted. So you can
17 see that in the chart as well. But then, you know, after we
18 got through that period, 2009, market prices began recovering.
19 You can see production started moving upward.

20 And then beginning in 2012, and couple of times in the
21 last couple of years it's piqued above that capacity as well.
22 So that's -- that's kind of how I put it together. I would
23 like to point out, it's very difficult to track these things,
24 and obviously, the base point for establishing this was in
25 2006. That's quite awhile ago now. But I would sort of drew

1 heart from this Exhibit 51, Eric Erba's outlook -- Dr. Eric
2 Erba's outlook, Eric with a "c" -- for 2010, and he estimated
3 California plant processing plant capacity. And let's see
4 here, I think his number, if I added these bars correctly on,
5 the version I have has no pages on it. Exhibit 51, it is the
6 section on processing plant capacity, and there's a chart,
7 Figure 5 in that document.

8 By adding those million pounds milk per day numbers
9 together, I came up with 120.2, and that was, I believe, in the
10 fall of 2010 when he was doing that.

11 Q. And your number is 120.5?

12 A. And my number is 120.5. So we're pretty close, doing
13 the same work independently I think, although he probably has a
14 better knowledge of that because he's more aware of what their
15 processing capabilities are, but the numbers were close.

16 Q. All right. So is that what you want to tell us?
17 Actually, let me ask one more question about Figure 2. There's
18 been, you have been here the whole hearing right?
19 Congratulations.

20 A. Yes.

21 Q. There's been testimony, there was discussion about
22 hearing records at CDFA, there's been other discussion about
23 when milk moved out-of-state. When, for instance, in the time
24 period that you are looking at would move above the red in late
25 2011, early 2012, or late 2013, early 2014. Is that consistent

1 with when you know that milk was moving out of the state?

2 A. It's consistent with what I know, yeah.

3 Q. All right. So we're back on Exhibit 79, and we're now
4 to a new section called Current Differences Between California
5 Class 2/3 Prices. You want to pick up there for a few minutes
6 before we're done for the day?

7 JUDGE CLIFTON: California class, what did you say?

8 MR. ENGLISH: I said between California class 2/3 prices.

9 JUDGE CLIFTON: Is that where we are?

10 MR. ENGLISH: Yes, I think that's where we are, your Honor.
11 He had just finished the paragraph on plant capacity, it ended
12 on page 29. So we're near the top of page 29.

13 DR. SCHIEK: Yes.

14 JUDGE CLIFTON: All right, good.

15 DR. SCHIEK: New section:

16 Current Differences Between the California Class 2/3 Prices and
17 FMMO Class II Prices are not Disorderly.

18 Class 2 and 3 prices in California have been
19 established relative to Class 4a, rather than Class IV or Class
20 II, for the purpose of maintaining a reasonable sound economic
21 relationship among the classes in California. If Class 2 and 3
22 prices are set too high relative to Class 4a, the result could
23 encourage substitution of nonfat dry milk and anhydrous milk
24 fat for use in manufacturing these products, instead of using
25 fresh cream, skim, condensed, and/or bulk milk.

1 BY MR. ENGLISH:

2 Q. So you deleted an a between "encourage" and
3 "substitution."

4 JUDGE CLIFTON: So Ms. Elliott, on page 29, the fourth line
5 down from the heading, we're just going to strike "OF", of.

6 MS. ELLIOTT: Okay.

7 DR. SCHIEK: To preserve these somewhat higher uses for
8 dairy farmers through pooling, Class 2 and 3 must not be priced
9 so high as, so high as to encourage dairy ingredient
10 substitution. The same logic applies to the relationship
11 between Class IV and Class II. However, it should also be
12 noted that because Class II milk received at stand-alone Class
13 II plants, or plants with Class II at lower usage, it is not
14 required to be pooled, the establishment of different regulated
15 prices under the CSO and under the FMMO cannot be considered
16 disorderly. If it were the case that orderly marketing
17 requires the same price to be paid for Class II milk regardless
18 of location, USDA would require that all Class II plants be
19 pooled. The fact is, they do not.

20 While it may be the case that differences in Class II
21 and Class 2 and Class 3 pricing leads to some ability for
22 multi-state manufacturers to engage in price arbitrage by
23 producing more product in states where the regulated price is
24 lower, this ability is limited by manufacturing capacity in
25 each location. If California's average price advantage had

1 been especially large, we would expect to see California Class
2 2 and 3 manufacturing expanded. Expanding. But there is no
3 evidence that this is the case. In summary, proponents of
4 Proposal 1 have little evidence that differences between FMMO
5 Class II and California Class 2 and 3 prices have led to either
6 disorderly marketing, either by making it more difficult for
7 Class 1 plants to obtain milk, or by encouraging uneconomic
8 milk movements.

9 BY MR. ENGLISH:

10 Q. We have like one section paragraph maybe, and then it
11 is longer, so maybe we can get that one paragraph done, your
12 Honor, and be done for the day, because the next section is
13 longer after that.

14 So why don't you read the next section, Current
15 Differences Between the California Class 1 prices.

16 A. Yes.

17 Current Differences Between California Class 1 Prices and FMMO
18 Class I Prices are not Disorderly

19 Class 1 prices, likewise, need to be in an appropriate
20 relationship to other classes within the market. California's
21 Class 1 prices are somewhat lower than FMMO Class I -- it
22 should be prices in.

23 JUDGE CLIFTON: Ms. Elliott, so we're on page 30, and two
24 lines down from the heading we're going to insert some words.
25 And so after the phrase Class I, how should it read,

1 Dr. Schiek?

2 DR. SCHIEK: Prices in contiguous states.

3 MS. ELLIOTT: We're just adding prices?

4 DR. SCHIEK: Prices in.

5 JUDGE CLIFTON: First insertion is "prices in" before
6 contiguous, and the second insertion is states after --

7 DR. SCHIEK: States is already there.

8 JUDGE CLIFTON: States is on the next line. Thank you.
9 Good. So Ms. Elliott is way ahead of me, which is great. All
10 right. So all we have added is prices in.

11 DR. SCHIEK: Correct.

12 JUDGE CLIFTON: And would you read that sentence from the
13 beginning, Dr. Schiek?

14 DR. SCHIEK: Yes. California's Class 1 prices are somewhat
15 lower than FMMO Class I prices in contiguous states, but the
16 potential for the regulated price differences to lead to
17 disorderly marketing (attracting milk in bulk and packaged form
18 that is not needed and resulting in inefficient milk movement)
19 is addressed by keeping Class 1 prices in California from
20 exceeding those in surrounding states, something CDFA has been
21 proactive about. Bulk milk that is not priced under CSO's has
22 been entering California and has continued to enter, but those
23 volumes are not increasing, but rather declining. And you can
24 look at Table 2.

25 BY MR. ENGLISH:

1 Q. And table 2 is just page 6 of Exhibit 80, you basically
2 took Exhibit 61 introduced by CDFA, Table X, and you took the
3 monthly data and added it together to show an annual, correct?

4 A. Correct.

5 Q. Just finish the paragraph.

6 A. Okay.

7 JUDGE CLIFTON: Before you go onto the next sentence, when
8 you have California state orders being plural in this section,
9 why is that?

10 DR. SCHIEK: Yeah. Probably should be consistent, because
11 we think of it as the California State Order, but really there
12 are multiple orders. There is the, under the authority of the
13 Dairy Marketing Section, there's an order for Southern
14 California that pertains to minimum pricing, there's an order
15 for Northern California that pertains to minimum pricing.
16 There's also an order for milk pooling that is in both areas,
17 so there's actually three orders, I guess, that we could talk
18 about. I think it, for simplicity, we probably ought to just
19 refer to it collectively as the California State Order, but
20 technically there's three.

21 JUDGE CLIFTON: All right. I like that you have it the way
22 you do. If you would begin that sentence again with bulk milk?

23 DR. SCHIEK: Bulk milk that is not priced under the CSO's
24 has been entering California and has continued to enter, but
25 those volumes are not increasing, but rather declining.

1 (Table 2.) If lower Class 1 prices in California are
2 sufficient to encourage packaged milk to move out-of-state and
3 into FMMO marketing areas where it could undercut Class I sales
4 from processors regulated by those FMMO's --

5 JUDGE CLIFTON: Ms. Elliott, we'll just make that plural,
6 do you see where he is?

7 MS. ELLIOTT: Yes.

8 DR. SCHIEK: Partial regulation exists as a remedy to
9 ensure that California Class 1 plants cannot press an advantage
10 created by lower regulated prices. Consequently, lower Class 1
11 prices in California, as they have been applied in recent
12 years, have not, and do not, result in disorderly marketing
13 conditions.

14 JUDGE CLIFTON: All right. So we have completed page 30,
15 of Exhibit 79.

16 And is there anything to be announced before we stop
17 for the day? Yes, Mr. Beshore?

18 MR. BESHORE: Well, I'm just interested in the plan for
19 tomorrow, since Dr. Schiek is not completed. Mr. Metzger is
20 here, so I believe, if I understood right, wanted to testify
21 tomorrow and I'm just interested in.

22 MR. ENGLISH: Well, I think we're going to put Mr. Metzger
23 on first in the morning, and then we'll go back to Dr. Schiek.

24 JUDGE CLIFTON: Do you anticipate, Mr. English, that
25 Dr. Schiek will consume the rest of tomorrow?

1 MR. ENGLISH: I have no idea.

2 JUDGE CLIFTON: If he does not?

3 MR. ENGLISH: We will have somebody.

4 JUDGE CLIFTON: Do we know who?

5 MR. ENGLISH: No, I do not know.

6 MR. BESHORE: Would that be on the ESL issue or on the
7 orderly marketing?

8 MR. ENGLISH: There's definitely going to be, at some
9 point, ESL testimony, if it is ready to go by the time
10 Dr. Schiek is done, that would be the logical flow. If not,
11 because I'm not going to leave gaps, I will try to have another
12 witness on disorderly marketing, at least that's my goal.

13 MR. BESHORE: Not sure, though.

14 MR. ENGLISH: Well, I'm moving pieces.

15 JUDGE CLIFTON: Mr. Vetne?

16 MR. VETNE: My understanding, your Honor, is that
17 Calvin Covington will be coming in tomorrow in hopes to testify
18 tomorrow or Wednesday, because he's going on a humanitarian
19 trip to Lebanon on Friday.

20 JUDGE CLIFTON: Okay. Good. All right. Then, I'm going
21 to ask for some help tomorrow morning. I would like to have a
22 table set up for a witness stand just correctly in front of my
23 bench, with a microphone. All right. Good. Thank you all.
24 And we now go off record at 5:02.

25 (Whereupon, the evening recess was taken.)

1 COURT REPORTERS CERTIFICATE

2
3 STATE OF CALIFORNIA)
4 COUNTY OF FRESNO) ss.

5
6 I, MYRA A. PISH, hereby certify:

7 I am a duly qualified Certified Shorthand Reporter, in
8 the State of California, holder of Certificate Number CSR
9 11613, issued by the Court Reporters Board of California and
10 which is in full force and effect.

11 I am not financially interested in this action and am
12 not a relative or employee of any attorney of the parties, or
13 of any of the parties.

14 I am the reporter that stenographically recorded the
15 testimony in the foregoing proceeding and the foregoing
16 transcript is a true record of the testimony given.
17

18
19 DATED: November 9, 2015
20 FRESNO, CALIFORNIA

21 

22
23 MYRA A. PISH, CSR
24 Certificate No. 11613
25

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