VERMONT MILK COMMISSION

IN RE: PROPOSED ORDER TO ESTABLISH
A RETAIL FLUID MILK PREMIUM

HEARING

Held on Tuesday, November 18, 2008,
at the Pavilion Auditorium,
Montpelier, Vermont.

COMMISSION MEMBERS:
Roger N. Allbee, (Chair)
Senator Bobby Starr
Representative Christopher A. Bray
Veronica Aseltine, Consumer Representative
Austin Cleaves, Dairy Farmer
Paul Doton, Dairy Farmer
Harold Howrigan, Dairy Farmer
John Thomas, Principal Owner, Thomas Dairies

Dan Smith, Special Legal Counsel
Reenie De Geus

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PROCEEDINGS: 9:09 A.M.

CHAIRMAN ALLBEE: Good morning, we are ready to convene the Milk Commission. We have a quorum. And my name is Roger Allbee. I'm the Secretary of the Agency of Ag and Chair of the Milk Commission. And I'm the presiding officer of the hearing this morning.

The Milk Commission has reconvened the hearing today, November 18, to take further testimony and evidence in regard to the proposed Order to establish a retail fuel milk premium adopted at the Commission's June 24, 2008 meeting. The hearing will be conducted in accordance with the Commission's Emergency Procedural Rule which is included in the hearing notice issued on August 21, 2008. Copies of the hearing notice as well as separate copies of the procedural rule are provided on the table at the back of the hearing room.

MR. SMITH: By the door.

CHAIRMAN ALLBEE: By the door. I recognize many of you were in attendance for the first September 9 hearing. For your benefit and those who were in attendance the last time, I will again ask our special hearing counsel, Dan Smith, to go over the process we will follow for today's hearing. Dan?

MR. SMITH: To repeat what we discussed at the last hearing, the hearing will result in a certified record of the proceeding including a transcript of the testimony and a complete record of all evidence received. At the conclusion of the hearing, Secretary Allbee will announce that the transcript will be available 48 hours after the hearing so as to allow participants in the hearing the capability to file proposed findings and conclusions in accordance with the provision's procedural rule contained in the Proposed Order as mentioned by Roger. I will speak in some more detail about that part of the procedural process at the close of the hearing.

With regard to witness testimony, each witness will be administered an oath or affirmation before testifying. The witness must provide name and occupation for the record and describe whether he or she is testifying on behalf of him or herself or on behalf of another. In the latter instance, the witness must identify whom he or she is representing. It will be fine for a witness either to read from a written statement or simply to provide oral testimony without anything in writing. I would mention that given the configuration of the hearing room, you need to speak up so that the court reporter can hear what you have to say. And as we discussed, for members of the Commission on the other end, particularly need to speak up for our court reporter.

If you have a written statement, please inform Secretary Allbee before beginning so we can receive a copy of your statement into evidence.

We will hear the witness statement first in its entirety. After the witness has completed testimony, any member of the Commission or myself or Ms. De Geus will be able to ask follow-up questions. Finally, I will note with regard to witness questions that anyone in the audience can also ask a question of a witness which is a somewhat unusual procedure. This process is subject to the Chair's discretion. If you wish to ask the question of a witness, there are forms on the table in the back of the room where the sign-up sheet was to be used to present your question. Please complete a form with your question on the form, raise your hand and Reenie or I will retrieve the form and give it to Secretary Allbee.

CHAIRMAN ALLBEE: Thank you. I guess at this point we need to to approve the minutes? Do we have any witnesses that want to -- would you just raise your hand and take the oath?

TESTIMONY BY BILL MACDONALD:

(The witness was sworn by Chairman Allbee.)

CHAIRMAN ALLBEE: We're receiving your testimony, Bill. The hearing is on distribution of funds, but your testimony will --

THE WITNESS: It is both written and there's a report also, so I have that available too.

My name is Bill MacDonald. I'm the owner of the Waits River General Store, and I am here on my behalf and also on behalf of the Vermont Grocers' Association.

I want to thank you and the members of the Commission for this opportunity to address you today both as the owner of a small independent country store and on behalf of the Vermont Grocers' Association. As I said, my name is Bill MacDonald. I own the Waits River General Store located on Route 25 in West Topsham, Vermont. Store is about 1200 square feet of retail space and it is 13 miles from New Hampshire border. My wife, Donna, and I purchased the store in April of 1990. We currently operate the store with one full-time employee and ten part-time employees. For disclosure, I am chairman of the Board of Directors of the Vermont Grocers' Association and I'm a member of the Board of Vermont Alliance of Independent Country Stores.

Vermont's not an island. We cannot continue to send our customers to New Hampshire. Currently New Hampshire has lower minimum wage. Their cigarettes are less expensive due largely to our higher taxes, and there's no sales tax or deposit law. I can provide anecdotal evidence of customers telling me that they go to New Hampshire for better prices or could recount the number of times I've seen my customers shopping in stores across the river. But instead I will be providing you with copies of border study that was completed in 2006 by Mr. Art Woolf of Northern Economic Consulting, Incorporated. I have copies available for the whole committee.

As the border study points out, New Hampshire and Vermont sales and counties along the Connecticut River were nearly identical prior to Vermont instituting its sales tax of 3 percent. As the rate has increased over time and with the extra costs associated with the bottle deposit system and higher taxes on beer and tobacco, there now exists a huge difference in sales between these two states. I work diligently to get the best products at best prices for my customers and currently am competitive even with Wal-Mart on milk. I have limited access to suppliers for dairy product in my area, but people make their milk purchasing decision based on price, more than they might on the product. So I try to keep my prices low and my profit thin.

I would not be able to absorb any increased cost; it would have to be passed on to the customer. The customer would soon learn that the cost for this same product was lower in New Hampshire, buy even more of their items there which would result in loss business, lost jobs and lost revenue for the state. My customers are your customers too. The money that leaves the state for food and beverage purchases rarely, if ever, comes back.

As the owner of a small store, I fully appreciate the growing challenges and dwindling opportunities faced on a daily basis by the dairy farmers in the state. We want to see everybody get a fair price for their product. We would, however, be more supportive of a new premium tax surcharge, fee, you name it, on milk if it were done on a regional basis and not just another item that Vermont stores would have to pay more for than our competitors across the river.

Thanks again for this opportunity. I would be happy to try to answer any questions you might have and I'm available at any time if you care to have further discussion.

CHAIRMAN ALLBEE: Thank you very much, Bill. Questions?

REP. BRAY: My name is Chris Bray. I'm just wondering if you indicated a role and willingness to perhaps pay like a regional premium, something like that. Are there any examples of products which that you've seen a program like that and how big?

THE WITNESS: At this time I'm not aware of any that have been in place. My only concern is to broaden the playing field and level the playing field. I am more familiar with the ones that affect only Vermont, so no, I can't.

REP. BRAY: And this is sort of a thinking out loud question. It seems like no matter what region we would define there would always be a border.

THE WITNESS: Oh, yeah. That's something we've looked at before with sales tax and everything else. They talk about moving a Connecticut Valley River buffer zone, if you will, that went into Marion and whatever. There's always going to be border. But, as it goes further away, the customer is going to be less likely to travel the distances. If we can get it further away from the confines of Vermont, I mean, there's going to be cross over into New York and Connecticut and Massachusetts and all at any time. But they are going to be less likely to travel at least out of Vermont.

REP. BRAY: Back in the beginning of your testimony you referred to a number of things that you see driving your customers out of state. So could you just list top one or two or three?

THE WITNESS: Sales tax. And then sales tax and sales tax. Sort of like location. But yes. Obviously the deposit -- bottle deposit is another issue. And, you know, right now it is just sales tax. Not just.

REP. BRAY: Thank you.

CHAIRMAN ALLBEE: Other questions? Bob?

SENATOR STARR: What type of a margin of profit does retail store need on a product such as milk to make it viable.

THE WITNESS: Every store is different. And every product is different. My break-even is 22 percent. But some are higher, some are lower, okay. I mean, most of the things I do for the state, whether it is lottery or hunting and fishing licenses or that kind of thing, that pays me five percent so I have to make that up somewhere else. Gas is five percent. So you got to make that up somewhere else. So I shoot for a 22 percent overall margin, but milk can be 25 to 30.

SENATOR STARR: And I know you mentioned customers shopping in New Hampshire. How does milk in Vermont compare to the price of milk in New Hampshire?

THE WITNESS: Right now it is competitive. Like I said, I can keep my pricing about the same as Wal-Mart's in New Hampshire. There is no -- the closest

Wal-Mart to me is 22 miles away. And I see my customers there every day. So it is competitive.

SENATOR STARR: Thank you.

CHAIRMAN ALLBEE: Bill, is milk a big part of your volume?

THE WITNESS: It is probably 8 percent of my inside sales, 8 to 10 percent of my inside sales. It is one of those things. Obviously we're called a general store but we are a convenience store as much as anything else. It is one of those things people pick up on their way home. So, yeah, it is a significant part of the business.

CHAIRMAN ALLBEE: Just a question. You said you're competitive with Wal-Mart which is a volume business. How can you keep your prices competitive with Wal-Mart?

THE WITNESS: Again, I'm able to keep my prices competitive because I'm able to purchase my milk through an agreement with the Associated Grocers of New England. It is delivered by Booth Brothers, Booth Brothers/Hood out of Barre three days a week. But the pricing and the marketing comes from HE New England in New Hampshire. I get a slight discount by combining that with my other grocery prices or grocery supplies.

CHAIRMAN ALLBEE: You mentioned, and I gather you're speaking on behalf of the Grocers' Association, too, that if there were a regional approach that would be more palatable. Now the Compact was a regional approach. Is that what's being proposed?

THE WITNESS: The devil is in the details. We would be more accepting of a regional approach only because it would spread the burden, if you will, but until we see a final proposal, I can't randomly endorse it.

CHAIRMAN ALLBEE: Understand.

THE WITNESS: But yes, we would be -- the conversation could go on a lot longer. And a lot more pleasant.

CHAIRMAN ALLBEE: Any other questions of Bill?

MR. HOWRIGAN: Just one. Sorry for being too late but the traveling was rough. The reason, are you aware of the critical situation that dairy farmers are in right now regards pricing?

THE WITNESS: Yes.

MR. HOWRIGAN: We are not getting enough to cover the costs -- or they aren't -- in production.

THE WITNESS: I understand. And again, this isn't anti-farmer. This isn't -- we're not even against the concept. The problem is focusing it on -- solely on Vermont and making it difficult for the small store to keep their margins and keep their customers. Helping the dairy farmer while hurting the retailer ultimately hurts the farmer, because he'll sell less of your product in Vermont and it is going to go across the river anyway. And that's been evident by cigarettes and beer and a variety of other products in the past five years. It is not that the cigarettes are -- I mean, there is some reduction in the consumption of cigarettes; but all you have to do is look at how many cartons of cigarettes I sell and how many New Hampshire sells. My customers are going over there and they'll go over there for milk and they were going over there for any number of things.

CHAIRMAN ALLBEE: One of the things just want to come back to because you were speaking, as you indicated, on behalf of the Grocers' Association. And we haven't heard from any of the large retailers. We've heard from the convenience stores about their costs and effect and the economic squeeze as well. But we haven't heard from the large supermarkets. Would they agree on some sort of regional approach as well?

THE WITNESS: I have to believe they would only because they're a regional entity anyway and save them a lot of hassle and paperwork by state -- going state by state; but I can't speak on their behalf.

CHAIRMAN ALLBEE: Yeah, I know. But we haven't heard about their margins. Only hear about your margins.

THE WITNESS: There are secrets in the business.

CHAIRMAN ALLBEE: All business.

SENATOR STARR: Pennsylvania. I don't think that state is an island any more than -- not even as much as we are. And they have in-state milk pricing. You know, we do have the Canadian border where Canadians come south to buy their milk which is a plus. And they run an in-state milk pricing program and I don't think their retailers have all left yet. Do you have an answer for that?

THE WITNESS: Well, I grew up in Bucks County, Pennsylvania, and I spent most of my working career, prior to coming up here, in Philadelphia. No. Philadelphia -- Pennsylvania is not an island. But it is a lot bigger. And where we can go 15 miles normally, except for days like today, we can go 15 miles in 15 minutes, I felt like I was back at home today when it took me a half hour to go two miles. So there's a lot more barriers, if you will, to leave the state and buy your milk somewhere else. Last I was in town, it was $3.50 to go across the bridge in New Jersey on the cheapest ones. Used to be a nickel. They don't do that any more. So there's a lot more barriers to leave the state and buy something. Pennsylvania's still losing sales to liquor. They are still losing sales to milk along the Delaware River. But there's a whole lot more of central Pennsylvania and whole lot more of northeastern and northwestern Pennsylvania where it just doesn't make sense. Here, we have a very small community, I mean, there's what? 600,000 people in Vermont? That's a neighborhood in Philly. So it just a lot easier than New Hampshire than it is to go to New Jersey.

SENATOR STARR: And then, do you recall what you sell your milk for on a gallon basis at your store?

THE WITNESS: This morning?

SENATOR STARR: Yeah, got an idea? I don't need the exact.

THE WITNESS: $4.29.

SENATOR STARR: So, do you know how much that equals a hundredweight?

THE WITNESS: No. Sorry. I don't deal in hundredweights.

SENATOR STARR: Well, you just take that and multiply it by 12.

THE WITNESS: Okay, so that's --

SENATOR STARR: Roughly 50 odd dollars.

THE WITNESS: 50 bucks, yeah.

SENATOR STARR: And do you know how much the farmer gets out of that $50?

THE WITNESS: No, I don't have any control of that.

SENATOR STARR: About $18.50.

THE WITNESS: That's pretty good. Do you know how much I get out of that $50?

SENATOR STARR: So what I'm getting at is when the milk man comes to your store, I would presume that he fills the cooler and then the rest goes in the back, and then you have to fill it maybe.

THE WITNESS: No, actually he just drops it.

SENATOR STARR: He drops it. So you have to pick the milk up, put it in the cooler and then you have to have somebody at the cash register to run your people through. The farmer has to raise the animal, feed that calf. I mean, for $18 they do an awful lot of work.

THE WITNESS: Absolutely and I'm not arguing that point. I mean, they chose to be farmers the way I chose to be a retailer. And a lot of people question my sanity. So the thing is if they are making $18 a hundredweight --

SENATOR STARR: No, that's what they get.

THE WITNESS: So if they get $18 a

hundredweight, I'm not getting $18 a hundredweight. That may be my gross. But again, you're talking about my expenses. I got to pay for the product, I got to pay for the utilities to keep it cold, I have to pay for the labor, I got to pay for the insurance, I got to pay for all the other incidentals that go all front of the business. So I think by the time we are done, his $18 a hundredweight gives him a little bit ahead of me on the retail level on milk.

SENATOR STARR: Well, let's say that you do your 22 percent, that gives you roughly $.80 a gallon while you multiply that by the 12, I mean, you're pushing 10 bucks.

THE WITNESS: He's pushing 18.

SENATOR STARR: Yeah, but who does the work and who's got the bigger investment? And to generate your $8 you have a cooler, electricity, somebody to put the milk in the cooler, and somebody to cash the person through. The farmer, I mean, I mean, I could go on all day what they have to put in to get their gross of $18 and that's what this is all about is trying to get a fair amount of money to the people that earn the money in proportion.

THE WITNESS: And you have to understand then that if any surcharge is brought in to help the farmer make that, those revenues increase, we're going to have to pass on to our customer. Because, by your example, they are getting $18 for what they do, and I'm getting $10 for what I do, about half of that. And I'm not saying I do half of the work that they do. I know the hours and the time and effort that they put in. But, we still have our time, efforts, and labor costs and everything else involved. And I don't know that half of what the farmer takes is an unreasonable amount. Plus I got to pay for getting it from wherever they send it. It is not like he's dropping it off at my doorstep on the way by. It goes to Barre, it goes to Massachusetts and then it comes to me. Or New Hampshire, I'm sorry. And then it comes to me. And so there's a lot of expenses involved in that. I mean, I can't -- what I charge for milk does not have a direct correlation to what the farmer gets paid for the milk. I can only charge for milk based on what I'm charged for my product.

SENATOR STARR: If I may, Mr. Chair, I only brought this up to make a point. And the last part of my point is you could mark the price of your milk at 14.29 a gallon if you want.

THE WITNESS: I could.

SENATOR STARR: Not practical but you could if you wanted. My farmer friend that's sitting beside me here, he's a price taker. It is whatever the milk company wants to give him is what he gets. He can't say to his milk company: Hey, I want $22 for my milk or don't pick it up. There's just none of that. He has to take what they offer. Where in the retail business, and then most businesses, you can charge what you think you can get, which is fine. But in the milk --

THE WITNESS: Prefer to think of it as charging what's fair to the customer but I understand.

SENATOR STARR: Well, what's fair to the customer but a farmer cannot do this under present law, and it is pretty sad. But, thank you.

THE WITNESS: I understand that and I appreciate that concern. I think that's an issue that needs to be addressed and can be addressed at the distributor, retailer, producer level. But to pass that, to pass this surcharge on to the back of the retailer is just to understand that there's not a lot of room to absorb that cost. It is going to go to the consumer. And that if it goes to the consumer along the Connecticut River Valley, then they are going to go to New Hampshire to get their milk. And that's going to cause a decrease in sales or at least a decrease in the anticipated revenue from this program because you're not going to be collecting it from the Vermont retailer.

SENATOR STARR: Thank you.

CHAIRMAN ALLBEE: Bill, you told me, I know only in your area because's you know we --

THE WITNESS: You got family.

CHAIRMAN ALLBEE: How many farmers are near by to your store?

THE WITNESS: I got to believe there are at least 15 to 20 active farms.

CHAIRMAN ALLBEE: And now you have like three.

THE WITNESS: Or five maybe. Five is probably stretching it. It could be closer to three.

CHAIRMAN ALLBEE: What do they tell you when they come to your store?

THE WITNESS: Just doesn't make sense to do it any more. It is not cost effective for them to do what they were doing before.

CHAIRMAN ALLBEE: Because of the price wars.

THE WITNESS: Yeah. I mean, gas didn't just go up. Obviously, grain has gone up tri-fold in the last year or whatever it is. And it is not coming down nearly as quick as it went up, none of it is.

MR. HOWRIGAN: Just for the record, the established price for milk right now is $17, not $18 a hundredweight.

REP. BRAY: Are there ever periods during which you sell milk at a loss at your store?

THE WITNESS: No. I'm too small. There's economies of scale where some places that sell at a loss. But I'm just too small to make that happen. And I don't run sales per se. I try to have a fair price every day so I have a very limited community. I handle 350 customers a day ballpark out of 12- to 1800 people in my community. They are not going to travel to me for lower price, specifically to me. I'm not a magnet store, shall we say.

CHAIRMAN ALLBEE: I think you're a magnet store.

MR. THOMAS: Mr. MacDonald, thank you very much for testifying today. You buy your milk through Associated Grocers, a huge company. Does it make any difference to you if the milk comes from Vermont or California or Massachusetts?

THE WITNESS: Personally to me it makes no difference at all but to my customers it absolutely does. They expect to see a Booth Brothers label on their milk. They don't go into the details of where Booth Brothers milk is coming from right now, but it's been traditionally Booth Brothers since I've been up here in 1990. We provided Booth Brothers milk which is perceived as local dairy. They, the customer, seems to prefer a local and they're okay with Hood because they understand they bought Booth Brothers. But the other option, the other problem I have is they are the only one I can get anyway. Where I got it directly from Booth Brothers or through AG, Booth Brothers Hood is only milk I can get delivered to my location quite possibly because of what some would consider remote rural location. Because we are 15 miles from the Interstate on one side and 20 miles from the Interstate on the other side, and they are the corridor of supply. Garelick, I think, comes within six miles but they don't come any closer.

CHAIRMAN ALLBEE: Thank you very much for your time.

THE WITNESS: Thank you.

MR. SMITH: Did you have your statement with you?

THE WITNESS: Yeah.

TESTIMONY BY BRUCE KRUPKE:

(The witness was sworn by Chairman Allbee.)

THE WITNESS: I swear that the testimony I provide you is written by myself and my name is Bruce Krupke.

CHAIRMAN ALLBEE: Bruce, who do you represent?

THE WITNESS: I represent the Northeast Dairy

Foods Association, Inc.

CHAIRMAN ALLBEE: And your testimony represents that association?

THE WITNESS: It does. This is approved by our Board of Directors on their behalf and on our membership, yes, it is. I'll wait until everybody gets a copy.

CHAIRMAN ALLBEE: Go ahead, please.

THE WITNESS: Thank you.

Dear Commission Members: My name is Bruce W. Krupke. I am Executive Vice President of Northeast Dairy Foods Association, Inc. which is a full service membership trade association consisting of dairy product processors, manufacturers, and distributors, primarily located in doing business in the Northeast United States. It is a pleasure to be here again before all of you, and thank you for the opportunity to give this testimony.

I'd also like to provide continued perspective and comments on behalf of our association's membership regarding Proposed Order to Establish a Retail Fluid Milk Premium and more specifically potential competitive disadvantages for any out-of-state business concern engaged in the handling of food products for retail sale in Vermont.

The members in our trade association are the raw milk customers of independent dairy farmers and cooperatives. I want to be very clear. For the record, our association opposes the Proposal to establish a retail fluid milk premium for beverage milk products sold at retail within the state of Vermont. We strongly encourage the Commission to vote no on the proposal.

It is our belief and opinion based on extensive review, research and communications with our members the proposal will not work as intended. Using basic supply and demand economic principles, the concept, if passed, will be fatally flawed and will disrupt the milk distribution system in the state of Vermont to the detriment of dairy farmers, milk processors, retailers and consumers.

I have in the past few weeks visited many retail outlets in Vermont, from Brattleboro to Burlington. I have surveyed retail milk prices from a number of different milk suppliers on the shelves of many retailers. In my survey, I found the price of milk varied from $2.99 per gallon to over $5 a gallon. Variances in prices I observed are completely understandable and reasonable. Retail store location, store size, shelf space allocated, local competition, store marketing preferences all account for the justification of whatever price was marked on milk at the time. Although a more important fact was revealed to me in my travels. I now understand how difficult it is for a milk company to distribute milk to their customers in Vermont. Retail outlets in Vermont are scattered throughout the countryside and in hard to reach communities. The roadways are narrow and winding and in general are not built for efficient and timely distribution. The cost of getting milk to Vermont retailers is greater than other areas for milk companies simply due to the geographic distribution difficulties in the state. Certainly you must realize these increased costs of distribution are passed on to their wholesale customers.

I made one other interesting observation. The retail prices for other commodities located in the dairy case seemed to be higher than those in places where I usually shop. Products such as eggs, butter, cheese, orange juice, and Cheese-Its were priced higher than I'm used to paying. I suggest the Commission consider there are many reasons and circumstances for pricing of retail products in Vermont other than the raw cost of the product used to produce it. I would also suggest the Commission take a field trip across your state to witness first hand all the variables of getting the product to market before implementing any new premiums on milk.

I would like to briefly provide you with some specific potential discriminatory effects you should consider before passing a wholesale milk premium.

1. If the proposal is passed it will increase the cost of doing business for out of state milk distributors selling milk in Vermont. This will be accomplished by mandating a monthly premium paid to the commission. Discrimination will occur against these distributors versus their competition not distributing milk in Vermont. One will pay the premium; the other will not. One will pay the mandatory administration fee; the other will not. Potential discrimination will occur against out of state milk distributors not selling into Vermont who do not receive pool payments for their dairy producers.

3. Class II, III and IV processors will be discriminated against because they will not receive pool payments from the Commission to pay their producers.

4. Class II, III, IV out of state producers who do not sell milk to producers distributing milk in Vermont will not receive pool payments like their counterparts in Vermont. This is discriminatory.

5. Progressive dairy farmer processor

cooperatives willing to compete by selling their products for less in your state will be discriminated against their competition not selling or distributing milk in Vermont.

6. Retailers who have the ability to take possession of Class I milk outside of the state of Vermont will have an advantage over those who cannot do the same.

7. Retailers in Vermont who border state lines will be at competitive disadvantage with their competition on the other side of state lines if the premium is passed along by their milk suppliers.

8. Producer processors in Vermont that will be excluded from the payment provisions will have an advantage against their competition in Vermont. Consider the consequences if Dean Foods, HP Hood, or even Thomas Dairy decide to purchase dairy farms, form partnerships with producers or buy cows to supply their milk plants to become excluded from the premium.

9. Organic milk producers in Vermont will be discriminated against by not being allowed to participate in pool payments. Consumers who are used to purchasing nonorganic milk will have less incentive to do so because the price advantage enjoyed will be taken away.

10. Milk processors who are vertically integrated who retail milk in Vermont will be discriminated against because the mandatory premium will increase their corporation's cost of doing business which will have to be passed along to customers outside of Vermont.

11. Discrimination will occur against milk distributors who are licensed by the state of Vermont by competition that the state has failed to recognize having sales in the state who are not licensed. Four current examples are the companies that distribute these milk packages in Vermont. Here they are in front of me. I am going to deter from my testimony for just a second.

This carton here, Glenview Farms, comes from Maryland; it is sold in your state. The company that distributes that is currently not licensed. Hershey chocolate milk. This company comes from a distributor in New York. Shamrock Farms, purchased in the Subway store in Vermont, comes from Arizona. McDonald's Milk jugs, sold in Vermont, this comes from milk that's processed in southern New Jersey.

I'll go back to my testimony.

I purchased these products in your state and I do not believe they are licensed to legally distribute milk in your state. Imagine the fallout if one major fast food restaurant chain is forced to pay the premium and their competition is not.

12. Milk sales to private learning institutions that are not excluded will be discriminated against from the payment provisions versus state-owned competitive colleges and schools.

13. Milk companies who sell exclusively by bid to Vermont government institutions will have a competitive price advantage over competition that do not.

We again caution the Commission to consider these and many other legal ramifications and potential discriminatory circumstances the proposal will create if passed.

At this time I would like to ask to read a supplemental letter from our legal counsel, Charles English, Jr., that he prepared for our original testimony supplied to you on September 16, 2008.

CHAIRMAN ALLBEE: Will you enter it for the record? I think we read the letter and it pertains to the Interstate Commerce Clause. Maybe you could hit the high points instead of reading the letter.

THE WITNESS: Yes, sir. Mr. Secretary, this is a letter I supplied to you two months ago that I was not allowed to read that was submitted in the record. I would like to read this. This is, I think, is very important and pertinent to the question and the reason you're holding this hearing here today.

CHAIRMAN ALLBEE: Could you hit the high points?

MR. SMITH: Bruce, the problem is he is not here to be questioned. So if it is admitted as written exhibit, it is not a sworn statement. And he's not here to be cross-examined. So it is coming in as an attachment to your testimony. So if you want to summarize it as part of your testimony and then you're available to be questioned about your testimony, that's fine. But reading the letter would --

CHAIRMAN ALLBEE: Summarize the high points if you would.

THE WITNESS: Mr. English, our legal counsel, provides very, very specific examples of legal cases that have been already tried that point to discriminatory practices when in-state pricing practices are created. And he finds after reading your proposal, based on these previous court cases, there are to be serious legal problems with what you're trying to do. And he warns you against passing the proposal and that if you do pass the proposal, it won't stand up to scrutiny under legal court cases that have preceded you and that you should take notice. And we're providing you with notice that you should consider this before passing the proposal. That's my summary. Thank you.

CHAIRMAN ALLBEE: I think if Mr. English was here I would like to sort of have a question and answer with him on some of the legality of. That's why counsel has expressed that.

THE WITNESS: I understand.

CHAIRMAN ALLBEE: Questions for --

THE WITNESS: I'm actually not done. I have one more paragraph if I could. Thank you.

Finally, once again encourage Commission members to vote the proposed milk premium down. Taxation by unaccountable representation is dangerous. The basic concept to transfer money from one segment of the industry to supplement another segment can't work due to one simple observation. I have attached a map provided by the Central Milk Market Administrator. The map shows the comparison of milk production to population in each state in the U.S. This is the map that I'm referring to. It is included in your packet.

Note Vermont's milk capita production amount of 4,074 pounds to that of other neighboring states. The map clearly demonstrates any attempt to extract money from milk consumers in Vermont to pay producers any significant amounts of money will be difficult to achieve any worthwhile results. Vermont simply does not generate ample wholesale milk sales to create sufficient funds to create funds to pay back to milk producers.

Interfering with USDA's Federal Milk Ordering system will cause harm to your state's dairy industry. As an alternative to the current proposal we encourage you to convene a study group in Vermont to discuss with producers and milk processor distributors in the Northeast Order how to best resolve issues within the Federal Order to better benefit the entire industry.

Thank you for your time and allowing me these comments on behalf of our association's membership. And I will be happy to answer any questions that you have. Thank you.

CHAIRMAN ALLBEE: Thanks, Bruce. Appreciate your testimony and at this time I open it up for questions from Commission members. Questions?

MR. HOWRIGAN: Thank you, Mr. Krupke, for your testimony. Who does your attorney Mr. English represent?

THE WITNESS: He represents -- we ask him to represent our association.

MR. HOWRIGAN: And you are IDFA?

THE WITNESS: No, sir. We are the Northeast Dairy Foods Association. We are a Northeast regional entity that's a trade association of 501(c)(3) licensed in the state of New York that is similar to IDFA but on more regional basis. IDFA is a national organization; we are a regional organization.

MR. HOWRIGAN: Are you a member of IDFA?

THE WITNESS: I am. Yes, we are. We are associate member. We are.

MR. HOWRIGAN: It is interesting you noted the difficulty of moving milk on Vermont highways. I'm anxious to remind you that farmers pay to deliver that milk to the processor. We pay all the way on these terrible back roads. Comes out of the farmers' pockets.

CHAIRMAN ALLBEE: Senator Starr?

SENATOR STARR: You travel from Brattleboro to Burlington I think you mentioned.

THE WITNESS: That's correct.

SENATOR STARR: I think Interstate 91 and 89 goes that complete corridor. So you were really on the super highways.

THE WITNESS: Actually I took the back roads. I went up through Grafton, Ludlow, Rutland, and then to Burlington.

CHAIRMAN ALLBEE: You did take the back roads.

THE WITNESS: Yes, I did, sir.

SENATOR STARR: I had a question about the same section of your testimony as Commission Member Howrigan. What I find when I go shopping with my wife is that the little mom and pop stores, I can get a better deal buying my milk there than I can at Shop and Save, Price Chopper, the bigger stores which up my way are right off the thru-way. So I don't know where you happen to stop to get your pricing, but I can do better buying milk right from my little mom and pop stores than I can buying -- pay $4.59 and $4.69 at these bigger stores which I would presume that you represent and --

THE WITNESS: I don't represent supermarkets, no, sir.

SENATOR STARR: No? Good. Well, one of the chains that we have in Vermont is owned by a foreign company, foreign-owned, out of state, out of country even. But they seem to be charging more for their milk in my studies than the mom and pop stores which we just heard from one gentleman that owns one at $4.29. Last Friday I think it was $4.59, $4.69 up at Price Chopper and Shaw's. So I don't know where you got your pricing from, but --

THE WITNESS: It wasn't a scientific study. I stopped at probably 10 locations, big and small, and you know, sincerely, all the Commission members, this is at the root of the heart. If you are sincere about what you're talking about, if you really feel that retailers in general are making more than what you would consider their fair share, whatever that is, that hasn't necessarily been established because it varies. The answer, Senator Starr, and this is an analogy that I'm sure you all can relate to. If you take somebody that owns a $25,000 house and you take somebody that owns a $500,000 house, the taxes the $500,000 house pays is a lot more. The upkeep is a lot more. The person that has a $25,000 house or condo doesn't have to mow the lawn, doesn't have to call the plumber, doesn't have the same roof upkeep, doesn't have the same number of windows to wash. Everything is more expensive for bigger. If you walk into a Hannaford or Shaw's, Price Chopper, their floors are polished, their ceilings, the whole ambiance is much more expensive. It is like shopping on Fifth Avenue or shopping on Main Street some place. There's a difference. And each retailer, depending on their marketing strategy, decides how much they need to make, not just on milk. But when you talk about milk in the dairy section, your previous, your previous witness, when you talk about your examples of what they're making on milk, that's just one product. There's probably 5- or 600 different products in that case that have to be paid for by somebody to rotate each individual piece of yogurt or every sour cream or half and half. First in, first out rotation inventory. Point is that the bigger, the more expensive. They may have a dairy manager and assistant dairy manager as salaried employees instead of hourly. They probably pay them benefits. The cost structure of supermarkets, small supermarkets, convenient stores, Right-Aid, Walgreen's, it is all different and it is all based on how they want to market the margins in their stores. And I would encourage you to consider that, that is the previous witness getting rich off of milk? Probably not. They manage their dairy section as a category in their stores of probably 10 different categories: health and beauty, meat, bakery, produce. And in each section it depends on what they need to do to compete against their competition. There is so many variables you can't describe them all. It would take weeks to figure out the proper structure of supermarket clearly. To answer your question, I just -- I caution you that this particular proposal is going to be very difficult to implement and have the intended results that you want it to have. I list a lot of problems and discriminatory problems and that was just beginning of the list. And if you're trying to work within this marketplace, be competitive, innovative, and that's then supply fresh quality products, it is very difficult. We all have a tough job to do. Thank you.

CHAIRMAN ALLBEE: Other questions?

MR. HOWRIGAN: I would listen very carefully to you and I would only state that I have been involved in the dairy business for a number of years at various levels. And during the past -- over the past years we have done numerous studies of the dairy industry and supermarkets and the various sections of the supermarket. And without exception, no matter wherever we've done the study, every single case, the dairy counter was the most popular section of every single one of those stores without exception.

THE WITNESS: You're right. And the reason for that, though, and you should understand, that the group that conducted that study were the American Dairy Associations producer-funded generic promotion program organizations like the New England Dairy Council and American Dairy Association Council out of Syracuse. I worked for the American Dairy Association back in the '80s. I actually was part of that group that first released the dairy case studies. And one of the reasons it is most profitable is because of the number of turns that you get in the milk section. It is the number of times that they restock that case on a daily basis. It is the volume that's created in the milk section. Take away that volume, McDonald's principles, the reason they can sell billions of hamburgers is because that's what they do. If we slow down that number of sales in the case and instead of selling four in a month, we sell three in a month, and if we take away sales, we have two in a month, what's that have to do? You have to transfer more margin to that product. I contend that, yes, you are correct, that there is a profit structure that retailers enjoy in the dairy section but it is due to the volume. If you can't get the volume, you needed to raise the margins on those individual products and that's one of the things that I've seen in my career; that because of milk sales going down overall, from 40 gallons to 20 gallons currently per capita, while we've seen soda go from nothing to over 50 gallons per person a year, we've lost sales. Therefore, you need to increase your margins on those items. That's why the price is higher. That's what I'm seeing in the marketplace. That's my experience.

Individual stores. You may have some stores selling milk for $5.50 a gallon or $2.99 a gallon. Again, it comes back to that store's ability to decide what they need to sell to overall maintain their margin of, what we heard, 22 percent, of the gentleman that preceded me, to make a living. I agree.

MR. HOWRIGAN: I'm awful glad you brought up the rotation process because in every single case you guys gone to the bank and the farmer, he is waiting three weeks to get paid.

THE WITNESS: In turn with us you'll find that of government institutions don't pay us for big business more than 45 to 60 days. If you go to a school district, you could be 60 to 90 days before you get your money.

MR. HOWRIGAN: Talking dairy counter supermarkets.

THE WITNESS: And even supermarket chains hold us out 60 to 90 days. The retailer gets their money immediately when they cash that, that's true; but it takes a while to filter down through the system. Federal government mandates when the milk processor has to pay the farmer. We have no choice. We have to pay the farmer every two weeks on the 15th and the -- every two weeks, for the simplification of the process. I agree. Thank you.

CHAIRMAN ALLBEE: Other questions?

REP. BRAY: I think in previous testimony and even when the exhibits you have today, you were talking about how milk has to compete with soda, for instance.

And I think you had alluded to the need to develop more products based on milk. Is that -- can you quantify or describe what's going on with the milk in the last 10 to 20 years in terms of creating new products as opposed to selling essentially just pasteurized, homogenized milk?

THE WITNESS: Every year within the dairy industry there are anywhere from 500 to 1500 new dairy products introduced in the United States. It is hard to believe. What are these products? You if you read our dairy trade journals, you'll see companies are coming out with all types of new products. Within the milk category we have seen new products introduced. Corporations like HP Hood, Dean Foods have produced new lower fat, more fortified products. The problem that the milk industry has that when we create new products is that they are regional companies. They don't have this major national brand advertising marketing campaign to put into launching a new product, and it is very expensive to do that. The research that's done is done by the most progressive milk processors out there, the Dean Foods of the world, the H.P. Hoods, and there are others throughout the country but there is one or two in the region that have the capability of doing that. A smaller milk processor is more regionalized that sells within a few counties. Doesn't have the capital or the return to develop new products. So when they want to do something, they can't. They are stuck. We see the bigger, more progressive milk companies spending money, doing research, marketing, advertising, promotion, geez, this is exciting product when you look at this, this is something that you work with. And I'll be honest, these are not great examples of what you're talking about. If you're talking about retail stores, you walk in, you see the old milk jug sitting there. Same milk jug we've seen for the past 30 years. Not totally true. Some companies have come with light filtered products, that kind of thing. But I don't think that answered your question; but if you're looking for breadth of understanding of what milk companies are trying to do to market their products and cost structure and all the things it takes to get it to market, it is very difficult. And it is very rarely successful to the point where we are seeing a good return on new product introductions in the milk categories in the supermarket.

REP. BRAY: For your association is the percentage of milk sold as fluid milk a declining percentage over time?

THE WITNESS: Yes, yes. The per capita milk consumption is the number I'll give you nationally. It is around 20, 20 and a half gallons per person. And what we see, we see the effects. And especially those companies that are located in urban areas, New York City; Hartford, Connecticut; Boston, Massachusetts; your mid-level cities. We have a lot of problems in trying to increase sales in those areas because of competition from sport drinks, the new energy drinks. These companies come in and put up big displays. They take shelf space away from us. They offer better profit margins. So what's a retailer going to do if I can make more money on this product over here and my margin is greater, who am I going to squeeze; how much space am I going to take away from the milk industry? And we face that kind of a problem that we cannot easily regain that space back in the supermarket. It is very difficult.

MR. DOTON: I'm on the other end of the scale from Mr. Howrigan. I'm now involved nationally on the milk promotion arena. And the organizations like H.P. Hood which partnership with DMI for their Simply Smart, that's been marketed more or less on a national basis. K2O adding whey protein concentrate to compete with the sport drinks, so there is funding. The DMI funds, though, are farmer funds which are being greatly increased many times by the funds that are included.

THE WITNESS: The return on investment you're talking about; is that correct?

MR. DOTON: And we do have a pretty good success rate on those because we do the marketing and make sure it's got research to show that it is going to not fail. But I would agree with your first statement; many of the products that were coming out were failures.

CHAIRMAN ALLBEE: Bruce, just a couple questions. You indicated that your organization represents processors, manufacturers and distributors.

THE WITNESS: That's correct.

CHAIRMAN ALLBEE: Since 1928.

THE WITNESS: That's correct.

CHAIRMAN ALLBEE: That's a long time.

THE WITNESS: It is. We celebrated our 80th year this year.

CHAIRMAN ALLBEE: Is there interest in having a local supplier milk by your distributors and membership?

THE WITNESS: There is. We support the dairy farmer. And that sounds just like a sound bite, I know. We don't want to have to haul raw milk from California to supply a milk plant in Albany, New York. That wouldn't make any sense, for all the obvious reasons, okay.

We operate under the Federal Order system. And that system dictates a lot of the marketing behavior that you see in the transportation of milk from the farm, in the inner transportation of milk between plants and companies. And because of that system, it provides basically a set of ground rules that we have to operate by that are specific and nonspecific that aren't written ground rules that are based on supply and demand and --

CHAIRMAN ALLBEE: Can I ask a question about that?

THE WITNESS: Yes, sir.

CHAIRMAN ALLBEE: Because it's come up. As you know, the Milk Commission had extensive hearings last year and I think you testified there. We had 61 witnesses over several days. And I know that we had the Milk Market Order Administrator from the Northeast, Mr. Rasmussen.

THE WITNESS: Mr. Rasmussen.

CHAIRMAN ALLBEE: Testify. So I want to ask you about the milk marketing if I could. You've said to best resolve issues within the Federal Order. What kind of issues do you see?

THE WITNESS: I could identify a few. But I'm not going to put them down for the record because our association hasn't taken a position on them. That would be my personal opinion.

The Federal Order system is the system in which we operate under. It is the umbrella. We have no choice when you mention that, and I don't want to open up a can of worms. But when you talk about dairy farmers being price takers, I want to go on record saying that the minimum price is set by the Federal Order system. Dairy cooperatives and independent dairy farmers do ask for more money and we do give it to them over and above. And I mentioned this in my first testimony two months ago.

Back to your question. The Federal Order system has -- let's just take a look at it nationally. California is not part of it. Central Pennsylvania is not part of the Federal Order system. Why is southern Maryland and northern reaches of Maine in the Northeast Federal Order system but not central Pennsylvania? There's reasons. Why isn't western New York part of the Federal Order system? The deferentials, zone deferentials, how milk is priced, when you take a look at the whole system, I'm not saying it is good or bad, and it is working right now to the point which it is created. I think that it has to start at the Federal Order level. Those are the rules that we're playing by right now. Change those rules and you got two games. You were playing football and baseball together with different rules.

CHAIRMAN ALLBEE: Why I ask one issue because it came up with Mr. Rasmussen's testimony, but there is a provision in the Federal Order that says the Market Order Administrator shall establish a regional cost production, although that's not being done.

THE WITNESS: That's a technicality. And I am not an expert at it and I don't speak on behalf of the Federal Order system. It is set by USDA out of Washington. Secretary of Agriculture has the power to do that. And he dictates what happens in the Federal Order system. This is why -- do you all also understand that in the Farm Bill, the 2008 Farm Bill there is a provision to create a Federal Order revision group, 12-person board. That hasn't been funded. I encourage you through your US representatives, Senator Leahy and others, to fund that organization, get it moving. Let's start talking about the Federal Order system. And from there, if they don't do their job, if they can't achieve the results that you want, then I think you would have a case. But the Federal Order system is the entity that we have to play by right now. We have no choice until that changes. And we don't control that. And I've said this before. Dairy farmers create a Federal Order system. They can change it. They are the only ones that get to vote for it. We can't do that. The retailers can't do that unless you're a dairy farmer and the change comes before you. You're the only ones that have the vote to change it. They can keep it or they can get rid of it. And so that's why I say it is important to take a look at that Federal Order and that's why my suggestion can be convene a study group. Take two or three of you. Our association right now, next Tuesday, Market Administrator's Office in Albany is sitting down with a few dairy cooperative leaders and four members of our association. We formed a study group and we are now talking about this. We are trying to figure out some of the good and bad of Federal Order system so we can go to our representatives and try to get some of these things changed.

CHAIRMAN ALLBEE: One other question. I'm aware that the cooperatives have formed a Greater Northeast Milk Marketing Agency. Are you working with that group?

THE WITNESS: No. That's a -- I know what it is. It is not something that I do work with. And I believe it is -- I really can't comment because I don't know more other than it is formed by cooperatives and it is a cooperative membership type of system, organization. Organization.

MR. SMITH: I have two procedural questions for you, Bruce. First, in Mr. Thelen's legal opinion there's reference in the first paragraph on the first page, the last sentence, "We agree." I am quoting. "We agree with the submission by Jerry Slominksi, Esquire on behalf of International Dairy Foods Association."

There's nothing in the record that correlates with that reference. This letter is dated September 8. Is that an omission that we need to correct? Strike that? Just give us some guidance on that.

THE WITNESS: Originally when I submitted the testimony on behalf of Mr. English, we were advised that IDFA was going to submit a letter. And they actually held that. And I didn't know that at the time. I bring this back now that I am aware again that they are going to submit a letter. So technically, I didn't know about it at the time but I am aware that they are going to submit a letter.

MR. SMITH: Pending receipt of that letter. Okay. Then in your testimony I think you deviated from your written text, and I just want to see which way you're intending to go.

At page 2, number 4, if you could just read back. The sentence starts, "Class II, III, IV out of state producers who do not sell milk to..." I believe you said "producers" and you meant to say "processors."

THE WITNESS: Meant to say processors. That's correct. Thank you.

CHAIRMAN ALLBEE: Just a couple quick come to mind. I know there's independent milk commissions in other states like Pennsylvania.

THE WITNESS: That's correct.

CHAIRMAN ALLBEE: Do you testify in Pennsylvania?

THE WITNESS: We do. We do.

CHAIRMAN ALLBEE: In support or opposed to?

THE WITNESS: The Pennsylvania Milk Marketing Board will hold monthly meetings, price adjustment meetings. They'll also hold hearings to support or change their entire system. It is only when there's a major change does our association get involved. We do not participate in monthly meetings. We monitor it but we have nothing to do with Pennsylvania system per se. But we have and we will, if necessary.

CHAIRMAN ALLBEE: The other question I pose is related to what Bill MacDonald posed from the grocery manufacturers where they said a regional approach, if it was in place would be -- without getting into details -- would be something that they might perhaps be able to support. Is that likewise your --

THE WITNESS: Not if it is individual state initiated. It is our very solid position that individual states that try to set pricing mechanisms for milk at any level deter and detract from the Federal Order system. I'll get back to you. The regional system that we currently support is Federal Order system. We have this regional system already in place; whether it is broke or not is debatable. But the regional system that I think you're referring is to is the Northeast Interstate Dairy Compact. We are very concerned about equality of the system. We've been forced for the past 80 some odd years to operate under the Federal Order system. Change the rules on us, and we find inequity. That's our problem. One, our first major problem is fairness within the system. We are operating under this Federal Order that dictates what we do and how we operate. Change those rules and we will have inequities. When we have inequities, then we don't have fair level playing field. That's where we start with our problems with any state-initiated program. If you get to a point where in the conversation where you can find a program that's fair, that doesn't give an advantage or disadvantage from a small or large processor or distributor, let's talk about it. Let's find out what it is.

In our study group that I talked about earlier that we're going to convene next Tuesday in the Market Administrator's Office in Albany, we're actually going to do that. We're going to throw to the wind and say, what if we didn't have a Federal Order system, how would you start? Imagine if we were in a college class and professor said, "How would you get milk from the farm to the retailer?" Let the class talk about it a little bit. But then if you laid down the Federal Order regulations, how would anybody imagine such a scheme? But it is what we have and we have to start there.

Fairness, equality, based on competitive supply and demand principles is what we are all about in a nutshell.

REP. BRAY: I just wanted you to come back to the Pennsylvania order. So has your organization formerly registered an opinion against that Order?

THE WITNESS: No, sir. No. We have no position. Officially we have no position with the PMMB order. We've never taken a position. Our Board of Directors has discussed it. But we currently have no position. It hasn't been a subject that I've been directed to work on.

REP. BRAY: And how about there's a system in Maine. Have you taken formal position on that?

THE WITNESS: No, we have not. That's another order that we have not taken official position on at this time.

REP. BRAY: And, you know, in a nutshell, not to open up the whole topic, what distinguishes this system from those that motivates your organization to speak in opposition to it?

THE WITNESS: You're looking to create something today. Those systems have already been in place. We are basically addressing the needs of our membership today here with what you're trying to do. It is not to say that we won't in the future address other state orders. It's just that we have no intent or position currently at this time to do that.

REP. BRAY: Thank you.

CHAIRMAN ALLBEE: Anyone else?

MR. SMITH: I'd like to ask you some questions about the substance of your testimony with regard to the distribution of funds. That's the stated purpose of this hearing. So you put a fair amount of summary statements in the record, and I'd just kind of like to walk back through a few of them.

Number 1 on page 2. You say that if the proposal is passed it will increase the cost of doing business for out of state milk distributors selling milk in Vermont. Can you explain, number one, how it will raise the cost of doing business, to what extent would the inferences that the processor would not pass along the increase to the consumer. So if you could explain that in number 1.

And number 2, you said discrimination will occur against these distributors versus their competition not distributing milk in Vermont. So, if you could explain that again. The inference is that they are absorbing the cost rather than passing it along.

THE WITNESS: Very good. Number 1, if the proposal is passed, it will increase the cost of doing business for out of state milk distributors selling milk in Vermont. We are going to be forced to pay the premium at wholesale level. That will be set by mandate law. We have to pay that, 30, 40, 50, 60 cents a gallon. What if we can't pass that through? What if the retailer says, you know, this is a tax on you; it is not a tax on us; we are not going to absorb it. That could happen.

MR. SMITH: Keep going. What happens if the retailer doesn't buy the milk from you?

THE WITNESS: Yup. So he doesn't buy it from us and they say, okay, we are either going to pass it along or stop selling milk to you. That could happen.

MR. SMITH: Where does the retailer at that point go to buy the milk?

THE WITNESS: Right. So what you're going to force is this major competitive situation where maybe you find a milk processor in Maryland who's already in your marketplace that says, you know, what I'm trying to get in the marketplace, I'll low ball this and I'll eat it. Maybe they are most cost-efficient processing plant. You force us into competitive situations where every milk processor is different. They need different margins to distribute their products to the marketplace. If you get to the point where retailer says if you pass that along, I will -- I am going to find another processor that's willing to sell it to me without passing it along. The potential exists that you're going to invite milk from farther away into your state just to get the business, just to get their foot in the door. And that's what we --

MR. SMITH: Why does it necessarily have to be a dealer farther away?

THE WITNESS: It doesn't. It could be right down the road, too, yeah.

MR. SMITH: Somebody down the road says -- what you're testifying is that somebody down the road, a processor down the road might be willing to absorb the assessment in their margin, are able to and would then absorb the assessment.

THE WITNESS: Perfect example of that.

MR. SMITH: What is the competitive harm there if it is a competitive force that's driven that and competitively the business is able to respond competitively? What's the harm?

THE WITNESS: Well, because the processor's located, let's say, in Pennsylvania through their PMB system is subsidized by guaranteed margins. We see this all the time in New York City where Pennsylvania processor will have established 80, 90 percent of their business in Pennsylvania, subsidized margin, and be willing to come into New York City and Long Island and low ball it. Ridiculously low prices to the point where you question if they are making anything on milk but it is to increase the volume.

The discrimination is that you're taking our ability to sell a product competitively out of our hands. We -- it is something that we want to do. Why shouldn't we be able to either lower our price or raise our price? But here we are being mandated to raise that price or at least eat it, and that's what we feel is discrimination.

MR. SMITH: I want to clarify that the carton of milk you raised in your testimony before is that that dealer is in the market unlicensed, and your later statement you made is that there's some, which I'll come back to, that there's some potential competitive harm in having unlicensed dealers competing. But that's not your testimony here. It is not because they are unlicensed they are not going to pay it. What you are saying is that dealer might be willing to absorb it.

THE WITNESS: That's one scenario, that's correct. But what I'm --

MR. SMITH: Not that they are going to avoid the regulation.

THE WITNESS: Well, you got to go out and find these companies. Currently you're not aware of them.

MR. SMITH: I understand. But that's a separate issue, right?

THE WITNESS: That's a separate issue.

MR. SMITH: We'll get to that. If I understand, you're really describing one example whereby a processor in another regulated area, in other words, Pennsylvania, might be able to recoup its reduced margin through that regulated price.

THE WITNESS: That's correct.

MR. SMITH: Number two, potential discrimination would occur against out of state distributors not selling into Vermont who do not receive payments for their producers.

THE WITNESS: Right. If under your scenario --

MR. SMITH: Let's use an example.

THE WITNESS: That would be fine.

MR. SMITH: Let's go ahead. If you don't have a dealer by name but you have a dealer in, say, an out of state processor in New York, say, is not selling into Vermont and not receiving funds. And what is the potential discrimination against that?

THE WITNESS: Syracuse area processor is selling all the way to Vermont border, competing against Booth Brothers selling in Vermont and selling just inside the New York state border, is one example.

MR. SMITH: Keep going. What's the --

THE WITNESS: Yeah. Booth Brothers is going to receive, first of all, they are going to be forced to pay the surcharge to the Commission. Let's use 30 cents as example. Are they going to be able to recoup that out of the marketplace? It is questionable. They are going to be forced to pay the assessment fee, which hopefully they can pass along as well. You're going to have increased costs of the administration within that dairy of record keeping, reporting, and so on. Cost of doing business is going to be higher for Booth Brothers Dairy, but if he wants to compete against the company that's from Syracuse on your border, who doesn't have to pay all those fees, there's discrimination there or even vice-versa. If Booth Brothers is available to pass that entire --

MR. SMITH: Excuse me. But the example is discrimination occurs against out of state. You're describing the in-state guy having the problem.

THE WITNESS: The example is what if Booth Brothers is able to pass that entire 30 cents along to their wholesale customer, and you're going to give them back -- well, the farmers in Vermont are going to be subsidized from the pool. Mr. Booth can say so that farmer -- well, we have $1 a hundredweight premium on that we were paying you over and above the Federal Order system; but because the state is going to give you 5 cents, you know what, we decided to give you 95 cents. So they are subsidizing the premium to the farmers there. So the person that's harmed is out of state who isn't getting the subsidy to pay their farmer so it is a true cost for that farmer of that extra nickel, let's say. That's one example. So did that answer your question?

MR. SMITH: I didn't quite get you. We got the nickel. You reduced the premium to the Booth Brothers, reduced the payment to 95 cents. So your Syracuse processor, what's he paying? He's paying $1.

THE WITNESS: Let's say he's paying $1 but they are going after the same farmer for the milk supply. That's where the competition comes in and discrimination could be felt.

MR. SMITH: Is $1 is coming out of pool in Vermont and the processor in New York has to make up the dollar that's coming out of the pool in Vermont.

THE WITNESS: That's right. The Vermont is being subsidized. Out of state is not. That's correct.

MR. SMITH: Okay. Number five, you indicate progressive dairy farmer processor cooperatives willing to compete by selling their products for less than New York state will be discriminated. Can you just give some examples to who these progressive dairy farmer processor cooperatives you have in mind.

THE WITNESS: One company might be Upstate Milk Cooperative out of Buffalo, New York. They are dairy farmer funded and owned. Let's say they have the ability to transport milk across the thru-way and into Rutland and they want to open up a new account. They want to take Price Chopper business, let's say, for example.

MR. SMITH: They have a processing facility, Upstate?

THE WITNESS: Yeah, they are a processor, very large company in New York state. And very competitive I might add.

MR. SMITH: So Upstate would be the cooperative's vertically integrated would be trying to market packaged milk across into the chain supermarket. Go ahead.

THE WITNESS: That's right. Okay.

MR. SMITH: And what's the discrimination there? They would have to pay -- I am not arguing.

THE WITNESS: No. We are trying to get to it, I understand.

MR. SMITH: So if they are subject to the same charge as, I don't know, it would either be Dean Foods or Hood, in your example, they are trying to take an account away from one of those two dealers. What's the discrimination against them in that example?

THE WITNESS: The focus is on the farmer aspect of this because they are farmer owned. If it is their policy, their mission to be the low cost supplier in the marketplace, they are not going to be -- they are being discriminated against because the farmer cooperative, let's say in New England that you might -- the big one in New England who might make similar products who doesn't care, who don't have that policy, who says, we're going to comply with the law and we are happy with it and so on. There's discrimination against the dairy producers mission statement of trying to be the low cost supplier when in fact they can't be. They are not going to be allowed to come in and basically low ball their competition and not be able to sell their product because now you're forcing both companies to sell at the same price.

MR. SMITH: That's not discrimination. Discrimination means people are being treated differently. They are not being treated differently. That may be contrary to their mission statement.

THE WITNESS: That's what I was referring to, mission statement more or less.

MR. SMITH: It is not discrimination, though; it is just not consistent.

THE WITNESS: Potentially.

MR. SMITH: Again, I am not trying to argue. Just trying to understand the term.

THE WITNESS: It is a fine line. I put this one in to give an example of a company that is vertically integrated as a dairy farmer-owned organization that says we want to go into a marketplace; but, you know what, we can go in and give the lowest price but we still have to pay the tax.

MR. SMITH: But if the charge is the same to both, why can't they undercut that level regulated cost?

You got the Federal Order minimum; you got the state over-order above the minimum. That's all legal. Why can't they come in underneath?

THE WITNESS: Well, they could and that leads you down the road to even more what I would consider a different type of discrimination. Since they are dairy farmer funded they can pay their farmers whatever they want to. They don't necessarily have to conform to the Federal Order provisions since they are owned. They can decide if they want to pay their farmers $1 or $50 per hundredweight of milk.

MR. SMITH: This has nothing to do with that. All we've done is regulate the minimum. If they want to do that, they can do that.

THE WITNESS: That's correct, that's correct.

MR. SMITH: I want to ask you about your four milk dealers in conclusion. If I understand what you're testifying, and I think it is very important what you're saying, you got four products coming in unlicensed. Is that what you're saying for the record?

THE WITNESS: Three that I'm 100 percent sure of. This one I can't read the milk plant code on so I'm not sure who is processing this. I thought I did. But they printed it on the dark side there, so I think I know who this is and they potentially could be licensed.

But what I think is happening with this product is who is processing it isn't the same company that's distributing it. And company that's distributing this is a food service company; and therefore that would be the company that would be forced to pay the premium on. And so I don't believe the company that's distributing this product, not to say the processor but distributor.

MR. SMITH: You're not aware of exception that they are operating under. Your testimony is that these companies should obtain a license and haven't.

THE WITNESS: Well, based on what I understand Agri-Mark while here in Vermont, I believe so. They are distributing milk for resale, I believe. I think they would need a license to do that. But it is my understanding, and correct me if I'm wrong, but all Class I milk sales in Vermont would be subject to the premium and these are Class I sales in Vermont. So I assume that they would be taxed or forced to pay the premium as well. That's my understanding.

MR. SMITH: If we can cure the licensing problem, we can cure your compliance problem. So I think we need to deal with the compliance issues. If somebody from the agency follows up with you, can you assist in --

THE WITNESS: I would be happy to.

MR. SMITH: We'll assume they are not aware of the license.

THE WITNESS: I do that for New York all the time, as a matter of fact. But then again, consider going down your road that if they are excluded from licensing, why should these Class I sales be exempt and not Class I sales in learning institutions?

MR. SMITH: Separate issue.

THE WITNESS: But another discrimination.

CHAIRMAN ALLBEE: Do you know Byron Moyer?

THE WITNESS: Yes, I do.

CHAIRMAN ALLBEE: Work with Byron.

THE WITNESS: Thank you. Be happy to work with him.

CHAIRMAN ALLBEE: Thank you very much, Bruce, for your testimony.

THE WITNESS: Thank you everybody. I appreciate it.

MR. SMITH: Oh, wait, we have a question from the floor? Bruce, stay seated just a second. This is a question for Bruce; is that correct?

REP. BRAY: Yeah.

CHAIRMAN ALLBEE: This is from Mike Seaver.

MR. SMITH: And you're with?

MR. SEAVER: H.P. Hood.

MR. SMITH: Mike Seaver on behalf of H.P. Hood.

CHAIRMAN ALLBEE: (Reading.) Is it true that the Federal Order directive to establish cost of production was set to provide fluid milk to consumers? Since there is only a 40 to 50 percent Class I utilization in the Northeast, no risk of running out of milk for fluid use and therefore no need to establish cost of production?

THE WITNESS: My best answer to that is yes. I agree.

MR. SMITH: There's no need to do a cost of production analysis.

THE WITNESS: Yes. Without further explanation, the cost of production issue raised by the question pertains to the supply of milk in the region. And that's as far as I can go with the answer. My expertise of the Federal Order law.

CHAIRMAN ALLBEE: Just a question relating to that. Do you know how much it costs to transport milk distance-wise?

THE WITNESS: I'm aware of generalities, I am. Yes. And I'm aware that the transportation costs have increased. I'm aware of the lot of the variables that go into transporting milk. Key word: Variabilities. How close a farmer is or not to milk plant and those types of issues I am. Any more specific --

CHAIRMAN ALLBEE: Well, specifically by transporting milk from a thousand miles versus 200 miles.

THE WITNESS: I don't have the exact cost from -- raw milk you're referring to? No, I don't have the exact cost, not off the top of my head, no.

MR. SMITH: Just one question about number 8. You're talking about the exemption for producer handlers?

THE WITNESS: Yes.

MR. SMITH: If I'm correct -- and somebody can correct me if that's in the business if I'm wrong -- but I believe, just for clarification, the producer handler exception in the proposed regulation is tied to the Federal Order producer handler exemption. So the volume limitation as well as the provision with regard to purchasing milk as opposed to actually producing the milk, which I think actually resolves the gist of your suggestion. In order for Dean to get the producer handler exemption for all their milk they have to produce all their milk and they have to buy, exemption will kick in. Leaving that aside.

Assuming that I'm right that the volume exemption is, I believe, 300,000 pounds a month.

THE WITNESS: Sounds about right.

MR. SMITH: Is there some point at which this Commission's then got the ability along the lines of what you're suggesting to adjust that? We don't have to go in lock step with the Federal Order exemption. There is statutory exemption that's actually less. So would you have a sense of where you would see competitive harm on volume, putting aside for the moment your essentially philosophical opposition but in terms of competitive forces; that the volume to a smaller dairy, you know, your out-of-state dairy, and you mentioned Thomas and in-state dairy, so on volume do you have a sense of where there is an issue?

THE WITNESS: Yeah. Clearly.

MR. SMITH: Given the size of the market in Vermont?

THE WITNESS: I think if you take the gentleman that preceded me and testimony in his store, if he's located next to a producer processor, boy, if that producer processor is excluded, whatever, whatever amount, there's a certain amount that I think there's a return on the investment for any producer to become a processor because you're not going to process 10 gallons of milk on your farm, okay. So there becomes a return on investment for that producer to have to create and maintain a processing facility. So there's some number there that I might even encourage the Commission to take a look at and see at what point does that become viable for a producer? So that would be your starting point. But my major point is that if you give a competitive advantage to anybody in the marketplace, even if it is just one store, what if that store's got a competitor down there that doesn't want to buy that?

CHAIRMAN ALLBEE: The Federal Order system has the exemption. So if are you testifying in essence against any exemption at all?

THE WITNESS: Absolutely. But also I want to bring up a point if you're not aware of it. There is an effort underway out there that I'm aware of, not officially, but I'm hearing through my contacts that there's an effort underway to eliminate the producer processor exemption completely, and reason for that is we got producer processor members that have become -- in different regions it is my understanding in the Federal Order system there are different variables.

MR. SMITH: With respect, that's not -- that's a completely different dynamic than we are dealing with here.

THE WITNESS: But it is.

MR. SMITH: So for here the issue is for here.

THE WITNESS: For here clearly I don't think you should give any exemption to any producer processor. It just provides more distortion. In my opinion I don't see the need to do that.

CHAIRMAN ALLBEE: Any other questions? Bruce, thank you very much.

THE WITNESS: Thank you everyone. Thank you.

CHAIRMAN ALLBEE: Could you state your name for the record?

THE WITNESS: Raymond DiSantos.

TESTIMONY OF RAYMOND DISANTOS:

(The witness was sworn by Chairman Allbee.)

CHAIRMAN ALLBEE: And who do you represent?

THE WITNESS: I don't represent any particular group. I was engaged by the Commission to assist in the preparation of some of the technical provisions.

CHAIRMAN ALLBEE: Good. Please have a seat and I think we need to take a five-minute break if you don't mind so people can use the restroom.

(RECESS TAKEN FROM 10:43 TO 11:00 A.M.)

CHAIRMAN ALLBEE: We appreciate your testimony. Oh, please go ahead.

THE WITNESS: Members of the Commission, I'm here this morning to present testimony on the provisions of the Proposed Order to Establish a Retail Fluid Milk Premium, specifically addressing the two issues of consideration in the Notice of Continued Additional Hearing Procedure dated November 3, 2008.

Since I am not either a dairy farmer or a resident of Vermont, I have no direct financial stake in this regulation. I was employed by the Commission to assist in the writing of the Proposed Order's regulatory provisions, pages 30 through 44 specifically of the Proposed Order. My knowledge and experience result in 41 years of employment with the New England and Northeast Federal Milk Order Programs from which I retired in 2003. At least I thought I had.

My responsibilities grew from field auditing, auditing supervision, chief auditor, assistant to the Market Administrator, and finally Assistant Market Administrator with the Northeast Federal Order. Prior to the consolidation of the three Northeast Orders in January 2000, I was part of a task group charged with drafting language for the Consolidated Northeast Order that both modernized its provisions while recognizing the unique characteristics of the three separate orders. During the existence of the Northeast Dairy Compact, my responsibilities included audit verification as it related to that program.

I would like to address specifically the issues in the Notice, Provision 5.1, Distribution of Milk

Eligibility and Receipt Premium. And I would like to begin by going over how the premium is calculated and I can pass out an example.

We can begin with the Announcement of Retail Fluid Premium Sample and how it would be calculated. I just started out with handler over-order obligation of $4, $4 per hundredweight. This is an example. Put some numbers, the numbers just to provide an example of how this would work, if we had an over-order obligation of $4 per hundredweight, what we would need to carry out this program.

First figure we need to know is how much Vermont route disposition we've got. In my example, I got 8,700,000 pounds for a given month which would have a value attached to that of $348,000. We're subtracting three percent of reserve for the WIC program. Brings the value down a little bit.

Next figure we need to come up with is total eligible producer milk. And in my example I've got 195,500,000 pounds. Now we'll get back to where these numbers come from in a minute. But as this program works, the way it is currently written, program would need to have a reserve balance on hand so they would withhold a certain amount for a reserve and then each month add half of that reserve back into the program.

My example shows what would happen the very first month of the program. There would be nothing in that reserve to add back in the first month. And we've come up with what --

CHAIRMAN ALLBEE: Can we ask a question while you're going along? Why would you have a reserve?

THE WITNESS: Well, because, as this program was in effect, there would be an audit function. And if based on audit some money was sent to be distributed to producers that was found to be overstated or understated, that money would come from the fund; or if the handler paid in, for whatever reason, for whatever reason underpaid or didn't pay, it wouldn't affect the bottom line.

We end up with an adjusted value of a little over $.17 and we withhold the reserve of one half of one cent plus the fraction that would eliminate the decimals. And the final premium per hundredweight would come down to $.17.

Now based on my example, there's an obligation of $4 that would result in a premium of $.17. In subsequent months we would be adding money at one half of that unobligated balance. So based on comparable numbers, if there were a $4 obligation, the $.17 might be 18 or 19 because there would be money added to this.

So now we need to look at where did we get the 8,700,000 pounds on which we are assessing the $4, and where do we get the 195 million pounds that result -- that makes up the pool where the money is distributed.

Down the bottom, just above the heavy line, 195 in my example is comprised of the Vermont producer milk of 194,500,000 pounds and non-Vermont producer milk of 1,000,000 pounds. That's the basis for the calculation. We need to look at where those two figures, the 8.7 million and the 195 million comes from.

CHAIRMAN ALLBEE: This is all fluid milk sold in Vermont?

THE WITNESS: Yes, the 8.7. And the 195 million pounds is the total amount of eligible producer milk.

MR. SMITH: Can I just interrupt you just to clarify? Vermont route disposition is a technical term for retail fluid milk sales in Vermont with the exempted milk out; is that correct?

THE WITNESS: That's correct. That's correct. On the other side of that sheet, this is where we can get into where the figures come from.

CHAIRMAN ALLBEE: Question: The Vermont route disposition, the 8.7 thousand, that's what you're collecting on?

THE WITNESS: Yes.

CHAIRMAN ALLBEE: And the 194.5 is what you're paying on.

THE WITNESS: 195.5 is what we are paying on. Yes. Now on the reverse side of that sheet, that 8.7 million pounds is the total of nonexempt Vermont route disposition. And I've got this set up in a way that basically I've got two Vermont handlers and a few out of state handlers, just for example purposes here.

You can see the 8.7 million pounds of nonexempt Vermont route disposition and the total eligible producer milk consists of all of the Vermont producer receipts, 194,500,000 pounds plus, in my example, there is 1,000,000 pounds of non-Vermont milk that's eligible for the premium. And if we could just look at this example and take one plant at a time.

The very first plant. Very first plant in my example. I've got nonexempt Vermont route disposition of 4,000,000 pounds in a given month. That plant, if you can say that plant has got a total supply of Vermont producer receipts of 24,000,000 pounds. And I split this up purposely. I'm assuming for purposes of this exercise 1,000,000 pounds the plant receives from its own producers that are not part of any, quote, nonmember producers and 23,000,000 pounds would be received as cooperative milk but Vermont milk.

This plant also receives non-Vermont producer receipts of 1,000,000 pounds in my example. The way the regulation is written, since there is more than enough Vermont producer receipts to cover the 4,000,000 pounds of fluid milk sales in Vermont, then none of the non-Vermont producer receipts are eligible for the premium under this program. All of the 24 million pounds of Vermont producer milk is because all of the Vermont milk, I'm positive that's the way the program is written, all Vermont is covered.

Example number 2 is another Vermont plant. And just for example, if we say there's total route disposition of 1.5 million pounds, all covered by Vermont producer receipts, then that plant would pay the over-order obligation on 1.5 million pounds and those producers, the 1,500,000 pounds of producer milk would receive the premium. Based on my example it would be $.17.

Now let's take some partially regulated handlers that have both Vermont producer receipts and non-Vermont producer receipts.

CHAIRMAN ALLBEE: Ray, when you refer to partially regulated, what do you mean?

THE WITNESS: Well, these partially regulated, these plants would be non-Vermont, non-Vermont plants.

The first case I got an example where there's nonexempt Vermont route disposition of 2 million pounds, Vermont producer receipts at that plant of 3 million pounds, and non-Vermont producer receipts of 22 million pounds. So the plant itself has got a supply of 25 million pounds, 3 million pounds of which are Vermont producers. Since the route disposition from that plant is only two million, it is more than covered by the 3 million pounds of Vermont receipts. The Vermont receipts would automatically get the premium but none of the 22 million non-Vermont producer receipts are eligible for the premiums in that case.

In the next example, plant D, I'm assuming that there is route disposition in Vermont of 1,000,000 pounds with no Vermont producer receipts. And the total plant has receipts of 10 million pounds, all of which is non-Vermont milk. In that case under this program, that plant would be charged $4 obligation on 1,000,000 pounds, and would receive the $.17 premium on 1,000,000 pounds.

And that premium that they received on the 1,000,000 pounds, the way the language is currently written, would be distributed among its 10 million pound supply.

And the third example. There's very little milk sold in Vermont by the third plant. There's 200,000 pounds. And there's 10 million pounds of Vermont receipts and 15 million pounds of non-Vermont receipts. That handler would be charged the $4 obligation on the 200,000 pounds, and the entire 10,000 pounds of Vermont producer receipts would be eligible for the $.17 premium and none of the 15,000 pounds would be out of state.

SENATOR STARR: Mr. Chairman? Could we back up, Ray, to plan D? Could you run through that again, because I don't know if I misheard you or on how that would work?

THE WITNESS: Okay. If there's an out of state plant that had 1,000,000 pounds sold in the state of Vermont, this is an out of state plant, has no Vermont producers. The total supply at that plant is 10 million pounds. They would be charged $4 on the 1,000,000 pounds and they would be -- on 1,000,000 pounds they would be given the premium of $.17. What would happen when they divide -- in this particular case, that group of 10 million pounds of producer milk, of non-Vermont producer milk would, would end up with 1.7 cents per hundredweight. Because the $.17 on a million pounds when you divide it with 10 million pounds.

SENATOR STARR: So our regulation, our regulation that we're working off from does not return that money to the producers that produce that million pounds. It is evenly divided amongst all the producers.

THE WITNESS: Yes. Because there's no way of knowing once the milk from that 10 million pounds of producer milk gets into the plant, I mean, which producers milk was put in the bottle to be sent to Vermont? I mean, there's no way of knowing that.

SENATOR STARR: I heard you right the first time. Thank you.

THE WITNESS: And we have an example where there may be a handler that has no route disposition in Vermont yet receives Vermont producer milk to the extent of 32 million pounds, plus some outside milk, 52 million pounds. In that case that handler would pay nothing in as far as the obligation, but the 32 million pounds of producer milk would still be eligible for the $.17.

And we have, in addition to the plants that we're talking about, the half dozen plants here, there's going to be Vermont milk to the tune of roughly 119 million pounds of Vermont milk that go to various plants that are not located in the state of Vermont or not going to plants that have any route disposition in the state of Vermont; that there's some Vermont milk that goes into that plant in West Springfield would be an example. That 119 million pounds of Vermont producer milk would be eligible for the $.17 premium. That's part of the total 195 million pounds.

And then there may be some Vermont independent producers whose milk goes to a plant that has no route disposition in Vermont. That's the very last instance, independents. And again, I'm just making up numbers here. If there were 5 million pounds of Vermont producer milk that went to various plants that had no route disposition in Vermont, it would be up to those plants to submit a report saying, hey, this is the quantity of Vermont producer milk that we received, and that producer milk is also eligible for the $.17 premium in my example.

And at the end of the day, there would be a total of 194,500,000 pounds of Vermont milk, which is the entire supply of Vermont milk, plus 1,000,000 pounds of non-Vermont producer milk that would be eligible for the premium part of the pool. Basically how the program as currently written is structured.

Now I sat through the hearing in September and listened to testimony and additional testimony today; and, you know, there have been a lot of issues raised. And I'd like to just address a couple of issues that in this notice for today, the likely impact of the proposed formula for the disbursement of producer blend price, the business operations of in-state and out of state fluid milk processing concerns. Well, the impact in dollars and cents shown by this schedule, who would receive what.

The second issue is whether or how the premium disbursement formula might work a competitive disadvantage for any out of state business concerns engaged in the handling of fluid milk products for retail settings in Vermont.

Now in my experience with the Federal Order program.

CHAIRMAN ALLBEE: How many years?

THE WITNESS: 41.

CHAIRMAN ALLBEE: That's a long time.

THE WITNESS: We are creating a pool here. There's some of money that's generated from the obligation on the 8.7 million pounds. And it is going to be distributed among total supply of 195 million pounds which basically is the total supply of Vermont milk. And we are creating in a sense a pool with the proceeds from the sales of milk in Vermont, this $4 obligation, is returned to the producers who supply this particular market, the Vermont market.

Now this is similar to what happened in the Federal Order program. The orders are based on where the milk, the milk is consumed and what is the milk shed for that consumption. And wherever you draw the line there is always someone just on the other side of the line. When we consolidated the Northeast Orders, the consensus was that the reasoning was that these days milk travels further and further and it is no longer localized markets. When I first started my employment, 1962, there were five or six federal orders in New England. Milk couldn't travel very far, either raw milk or packaged milk. As times change, conditions changed. We've got to the point now where there's one Northeast Order. Yet you could still question whether any Vermont milk is part of the reserve supply for Virginia, the southern part of the Northeast Order, or whether any of the Virginia milk serves as a reserve supply for plants in Vermont, Maine or any part of New England. Nevertheless, the Order is what it is. And in each of the Federal Orders that exist today, and prior to the consolidation in each of the existing orders, every order has regulations on how they determine what the qualifications are for being a part of that order. And there is not just one magic formula that would make that determination. Every order, based on the circumstances had different conditions for qualifying to be part of that pool. Some of the federal orders had very lenient pooling requirements. Other federal orders had very strict pooling requirements.

CHAIRMAN ALLBEE: Who makes that determination?

THE WITNESS: Well, basically it is the producers in voting for the acceptance of that particular Federal Order.

In this particular case, the pool we've created here is route disposition of roughly 9 million pounds a month and we are saying that the supply is the Vermont milk supply. Now we are extending that to a case where in the one example here there is one example that has one million pounds of route disposition but has no Vermont. So obviously a portion of the Vermont requirements are being supplied by outside milk. And in recognition of that, that one million pounds is eligible for the $.17 premium.

Now you could ask the question as to why in each of these cases why isn't, if that particular handler is supplying the Vermont market, why isn't that handler's entire supply eligible? Well, you can do that and then you increase the size of the pool from 195 million pounds to 295 million pounds and you lower the premium, and it just begs another question is, why not extend this even further? And you could go, keep extending this until you could say that all of the Northeast

Order -- I mean, why don't we just mirror the Northeast Order and take the premium from 8 million pounds of milk and distribute among all the producers in the Northeast Order? But in my opinion, the way the regulations are written provide for the least amount of disruption and the most efficient movements of milk, either packaged milk or producer milk. If you're a Vermont handler and you got Vermont milk, if all of the milk sold in Vermont were produced in Vermont, there would be no reason for any moving of any milk anywhere. We open the door a little bit and we say, okay, that plant that has no Vermont producer receipts should be entitled to something. The million pounds that he gets the credit on when he divides it among his 10 million pounds of non-Vermont supply, it amounts to 1.7 cents, not $.17. It is not enough to cause him to do -- to move milk uneconomically for 1.7 cents a hundredweight. If his entire supply is eligible, then I would suggest that there are half a dozen other handlers that would be willing to come into state of Vermont and perhaps be able to sell such small quantity of milk in Vermont and be part of a pool that shares at the same rate as everyone else. And then the money gets divided among 40 million or 50 million pounds when the sales by that plant may be just one small customer. And it is just to me not a rational way to do the program.

In terms of a competitive advantage or disadvantage, everyone selling milk in the state of Vermont is paying the same obligation, whether it is $4 or whatever price is set. I don't see that there's any advantage or disadvantage to anyone.

And I think we need to make a distinction between competitive situations and competitive decisions that handlers make, on the one hand, and a competitive disadvantage that's caused by the program. If everyone is subject to the same price, they are all paying $4, then the program is not causing anyone a disadvantage or an advantage in my opinion. Someone chooses to come in and low ball a price, it could happen now without this program. In terms of the disbursement of funds, the non-Vermont, in this example, and the way the program is written, the one million pounds of non-Vermont receipts, it is recognized that some of the milk sold is from outside sources. And they get a proportionate share. But the share ends up to be 1.7 cents, and I don't think that's enough to cause a handler to jump through too many hoops to move to stop receiving Vermont milk and replacing the Vermont supply with out of state milk just in order to get a piece of the premium. Because once they divide it among their entire supply, when you consider hauling costs, I mean, it is just unworkable, in my opinion. I think I've gone on enough here. If we have any questions on --

CHAIRMAN ALLBEE: Questions for Ray?

SENATOR STARR: I got one. Ray, when you worked for the federal Milk Market Administration, in auditing, did you ever run across what it cost to move milk from one point to another? The previous person that testified talked about moving milk from Buffalo to, I guess, Vermont? What would that cost?

THE WITNESS: Well, I can't testify as to the cost. My background is not economics. We kept economists on our staff who studied the cost of hauling and that. I can't tell you. My role in the auditing function is to -- was to determine that if a handler deducted $.50 or $1 per hundredweight from payment to a producer for hauling, that the actual cost of hauling was that amount; and that they weren't deducting $1 of hauling when the cost was $.50. But there were a couple of issues that I would like to bring up in relation to the prior testimony. There were an example of four different products that were sold in the state. And I would say this: Number one, remember that in the provisions as written any handler whose sales in the state of Vermont are less than 150,000 pounds a month are exempt. Now there are only two possibilities with respect to those four products. They are either sold by a particular handler in the state of Vermont directly by the handler that produced the product, and in which case I would be surprised if the totals exceeded 150,000 pounds. They would be exempt. Whether you need to get involved with licensing, that's another issue. But if that were the case, it would be exempt.

If one of the handlers that normally distributes milk in the state of Vermont has a call for a particular product that he does not package in his plant so he purchases small quantities from a larger dairy that supplies it, then that product becomes part of the reporting handler's obligation. So in that case it would be reported. I would like to make that point.

Another point that was made by the previous, in the previous testimony was with this regulation the danger of someone coming in and establishing a producer handler operations to just be exempt from the whole, thing. To do it here would be, I mean, the Federal Order provisions have the same exemption for producer handlers. And, yes, there are producer handlers in the Northeast Federal Order and there are producer handlers throughout the country. And in my experience they haven't just taken millions and millions of pounds of sales away from everyone else. I mean, you are a producer handler. When you increase your sales volume, you increase your work responsibility. As a matter of fact, if I recall in September's testimony, there was testimony from Monument Farms. And his testimony was that he didn't want the added volume because it meant addition of work. So I would just address that.

CHAIRMAN ALLBEE: Are there other questions for Ray? Ray, just a question. Mr. Krupke indicated that and you've addressed it some in your testimony, interfering with the Federal Order system. And one of the questions that was brought up, I guess the question Mr. Seaver proposed through us, was the cost of production in the Federal Order system and that I think you heard the question.

Is it true that the Federal Order directive to establish cost of production was set to provide fluid milk to consumers? And since there is only a 40, 50 percent Class I utilization in the Northeast, I think around 40, 45 percent, no risk of running out of milk for fluid use and therefore no need to establish cost of production?

THE WITNESS: Well, I can't comment on that. I mean, the economists in the Federal Milk Order Program, gets into their area. I was never involved in that particular part of the program.

CHAIRMAN ALLBEE: Questions?

MR. SMITH: Ray, couple questions. First, just generally, am I to understand that these are examples of types of plants without intending to specifically identify particular production of any of the particular plants operating on the marketplace?

THE WITNESS: Well, I retired from the Federal Order system in 2003 so I've been away from it for a while. So I don't really know what's happened too much about what's happened between then and now. I know there are basically two plants in Vermont, and I know there are basically three or four plants outside the state that distribute milk in Vermont. And I know of in-state plant, one is significantly larger than the other. And I put just some numbers together just on that information that I have, just general knowledge of that. I think most everyone has general knowledge. But they are not intended to be representative of any particular plant except that, you know, plant A and plant B, I think we can all assume that is Hood dairy plant possibly and Thomas Dairy.

MR. SMITH: So in essence we've got the Hood plant with the bulk of the route disposition in Vermont, but the plant is substantially greater than just Vermont route disposition. So you've set that up as an example that reflects the reality, but those volume figures are not the actual volume figures. They are just examples.

THE WITNESS: No.

MR. SMITH: And similarly, what you've described as a partially regulated handler, I just looked through the definition. Everybody is a plant. So we've got Vermont plants and we got out of state plants. That's the distinction.

THE WITNESS: Right.

MR. SMITH: So we got the big Vermont plant and the small Vermont plant example. And then we got the relatively large, out of state plant. There are three relatively large, out of state plants in your example covering three different scenarios of receipts and receipts and sales in Vermont and receipts of Vermont milk and sales elsewhere.

THE WITNESS: Correct.

MR. SMITH: With regard to the decision of sourcing the plants, to what extent are the plant operators involved in that decision so that if there was a decision to divert milk in different patterns, would it be the plant operator that would be making that decision or the cooperative supplying the plant? If you could just expand on that a little bit.

THE WITNESS: Well, in today's world, the co-ops supply most of the milk. I don't believe the plant operator has too much control over where his milk is coming from except that he could decide he's no longer receiving from cooperative A and begin receiving milk from cooperative B. I believe that's the extent of his input. But I don't think any plant operator can pick up the phone and call his cooperative and say, I don't want to receive any more milk from producers A, B, C. I want my milk to come from wholly separate group. He can try that. But I believe the cooperative has control of movement of milk.

MR. SMITH: Is that from your understanding would be the same? There would not be a distinction there between in-state and out of state?

THE WITNESS: That's correct.

MR. SMITH: That's the interstate shipment of milk.

THE WITNESS: That's correct.

MR. SMITH: So if we are looking for a distinction between in-state and out of state impact, that dynamic would operate in either instance.

THE WITNESS: That's correct.

MR. SMITH: Mr. Krupke gave an example of somebody that wished to come in and low ball the market, and in which case the dealer would, in effect, say, I'll absorb the assessment rather than pass it along to the customer. It would seem that that example would come across either in your plant A or your plant C or D, I suppose. But just looking at if we could try to track that through and see how it might play out.

If we look at plant C, according to Mr. Krupke's suggestion, and I'm summarizing and hopefully accurately, but we'll just take the scenario as I understood his testimony was that a dealer in Pennsylvania could come up to the customer in Vermont receiving the milk from plant C and in effect low ball off the premium. And in that case the competition would be between that out of state plant and the out of state plant in Pennsylvania. Does that track what you heard Mr. Krupke suggesting? Just trying to see if we can chase through his concern.

THE WITNESS: Yeah. I think it does. But like a lot of other issues, you can build a lot of hypothetical cases of what could happen. But, I mean, in reality, when you consider the cost of hauling and consider all things considered, with this program someone's going to come in from Pennsylvania with out of state milk?

MR. SMITH: Well, so it would be displacing the

Vermont supply -- your plant C, the out of state plant with the relatively large percentage of the route disposition to Vermont, has some Vermont supply and substantial amount of out of state supply.

THE WITNESS: Yes.

MR. SMITH: So you would be, in effect, displacing in that example two million pounds against 25 million pounds for the month.

THE WITNESS: Against 25 million pounds.

MR. SMITH: So is the cooperative -- I would think you would need both an independent plant in Pennsylvania that's not the same company of either the two, of either of the companies that are operating the sales in Vermont; otherwise, one company is taking milk away from its own self, right? And then you would also have to have the cooperative, an independent cooperative from the cooperatives that are supplying the Vermont market as well that's sourcing that plant. So like you said, there are a lot of predicates to the movement of milk to get to that example.

THE WITNESS: That's correct.

MR. SMITH: Take some time to study it but I guess I have nothing further for now.

CHAIRMAN ALLBEE: Harold? Chris?

REP. BRAY: I just would like to review the math on a very basic level. And I'm looking at the, I don't know how close these numbers in your sample are to current reality. Are they ballpark, good ballpark figures, would you guess?

THE WITNESS: Well, I mean, they are probably reasonably close.

REP. BRAY: I'm just looking for orders of magnitude here. So, for instance, then, in looking at the sample, am I correct to say that 8.7 million pounds of milk are the milk that's paying the premium, and that's being distributed to the producers of 195,000,000 pounds. Okay, so if I do a little quick math, I mean, it is where we are looking at assuming it all went to the consumer, they would be paying then roughly $.33 a gallon. And assuming it all went back to the farmer, there were no overhead operating the system, we are delivering back to those producers 1.4 a gallon.

THE WITNESS: Okay. Yeah.

REP. BRAY: Thank you.

THE WITNESS: That would apply to the Vermont producers. Any non-Vermont producer milk would get the same dollar amount on the -- but it may, it may be a whole lot less then because that would be distributed among that plant's entire supply.

REP. BRAY: So the non-Vermont milk, they divide it up just as fairly in their entire pool. So it falls off. Okay, thank you.

THE WITNESS: Yeah.

MR. SMITH: Just to follow up on Chris's questions about the numbers. If I -- on your disposition and producer receipt sheet you got an asterisk on the nonexempt Vermont route disposition. Nonexempt meaning under the price regulation, the Proposed Order price regulation, this is the net, 8.7 million pounds a month is the net as the asterisk says. It excludes the nonretail sales. Those are exempt. The organic sales and producer handler sales. When you take out the exceptions, you net out about 8.7 million a month.

THE WITNESS: That's correct.

MR. SMITH: Similarly on the receipt side, you have double asterisk at 194.5. That assumes 215 million pounds a month. That's a minus less the organic milk and the producer handler milk.

THE WITNESS: Yes.

MR. SMITH: And 215 million a month times 12 would be roughly 2.5 billion for Vermont's producer milk.

CHAIRMAN ALLBEE: Did I hear you say in the question that Counsel Smith asked that it is possible that they could take milk from Pennsylvania and displace the Vermont milk, avoid paying the premium?

THE WITNESS: Well, they couldn't, they couldn't avoid paying, they couldn't avoid paying the obligation. Any sales in Vermont are subject to the obligation. In terms of the premium, they would be required, whatever premium they got are required to be paid to their producers.

CHAIRMAN ALLBEE: Talking about Vermont producers.

THE WITNESS: Vermont producers. Well, what it would do, it would probably dilute the pool just a little bit they displaced. Let's put it this way. If all of the Vermont, that entire supply were supplied by Vermont producer milk, then we got the proceeds from 8.7 million pounds to be distributed among 194,500,000 pounds. If every pound of Vermont milk were displaced, the sales coming in from whatever source is still subject to the $4, right? All it does is -- and in the Vermont producers are still entitled to the full premium, whether or not their milk is used to supply part of the 8.7. All it does is it increases the size of the pool from 194,000,000 pounds; it increases it by an additional 8 million pounds. So absolute worst case scenario is all of the Vermont milk is displaced and it does next to nothing, reduces the premium by a fraction of a penny.

SENATOR STARR: Ray, if you took your -- and I'm trying to find a way to punch some holes in your testimony. If you took plant D that it has a million pounds of milk sold in Vermont, then you went over and you replaced the 10 million pounds to 1,000,000 pounds, so you add a 20 million pound plant, and they were selling 10 million pounds in Vermont, you'd collect $.17 or it would be 8.75 for every one of your producers, say, for New York. If you took the 8.75 and you used that as leverage to low ball the Barre plant, say, why I asked the question in shipping is the movement of that product from New York state to Barre's going to eat up all the cost of any scheme that we can possibly put together. So it is noncompetitive. It isn't going to work that way, is it?

THE WITNESS: Well, in my opinion, the smaller the out of state plant, the less likely that plant is to have the capability of moving milk into Vermont. And although it would have a greater impact if that out of state plant had total production of only two million pounds a month, yeah, they share the proceeds at the rate of about 8.5 cents in this particular month. But a plant that has a total production of only 2 million pounds a month, I mean, theoretically it could happen but I don't know of such a plant.

SENATOR STARR: Thank you.

CHAIRMAN ALLBEE: Any other questions of Ray? Thank you very much, Ray. Do we have any other that would like to testify that haven't? William? Please.

TESTIMONY OF LEON BERTHIAUME:

CHAIRMAN ALLBEE: Thank you. Just raise your hand and state for the record who you are and who you represent and your testimony is truthful, factual and presented it as evidence.

THE WITNESS: My name is Leon Berthiaume, and I'll be representing the Green Mountain Dairy Farmers Cooperative Federation as well as Greater Northeast Milk Marketing Agency. And, again, the information to be presented is, to the best of my knowledge, truthful.

CHAIRMAN ALLBEE: Thank you.

THE WITNESS: So again, good morning. I am Leon Berthiaume. I am general manager of the St. Albans Cooperative Creamery and Chair of the Greater Northeast Milk Marketing Agency which is referred to earlier today. I testify today on behalf of both the members of Green Mountain Dairy Cooperative Federation as well as Greater Northeast Milk Marketing Agency, collectively referred to as "The Cooperatives" in my testimony.

Cooperatives support efforts of Vermont Milk Commission and other federal and state agencies to promote a smaller dairy industry and obtain better returns for dairy farmers. We also support many private sector cooperatives working toward the same goals. These organizations many of you are familiar with are Green Mountain Dairy Farmers, the National Milk Producers Federation, Northeast Council of Farmers Cooperatives, Cooperatives Working Together, US Dairy Export Program, Dairy Management, Inc. and others. Maintaining and improving our dairy industry requires the best efforts of many, both public and private.

As cooperatives, our efforts are to bring farmers together to address common issues whether they are local, regional, national or international emphasizing really long-term, sustainable actions which can survive and will serve to support the long-term growth of member income.

Today, with that background in mind, we offer a few comments on the Vermont Milk Commission's proposed regulation. We believe that, properly designed, the Commission's regulation can help to provide sustainable income enhancement in today's dairy environment. To do so must be based upon sound legal and economic principles.

The Cooperatives support state-administered pricing for Class I milk use and products. The competition for these products, though it has grown in geographic scope, still is fairly confined to the northeastern United States which, being bordered by Canada and Atlantic Ocean, is somewhat competitively insulated.

We understand there are important legal principles which set some clear boundaries in guiding Vermont's decision to administer a Class I over-order pricing program. I do provide this caveat, I am not an attorney. However, I encourage the Commission to review all the applicable law to understand its opportunities and limitations. A regulation that is not supported by strong legal underpinnings will not be sustainable and has the risk of being disruptive and harmful to its objective including dairy farmers' income.

We believe that state milk regulations need to adhere to a number of legal and practical considerations in order to be successful. Several of these principles are important today in our view. First, states cannot lawfully regulate transactions which occur outside of their territorial boundaries. Consequently, if a Vermont food store or distributor goes outside the state of Vermont and acquires fluid milk products which are then brought into Vermont and offered to consumers here, the price at which those products were acquired outside of Vermont is not subject to the regulation by state of Vermont. Similarly, if milk is delivered from a Vermont dairy farm to a buyer outside the state of Vermont for processing and the dairy buys the milk f.o.b. its plant outside Vermont, the state of Vermont cannot regulate that price of that transaction even if the milk was originally produced in Vermont.

On the other hand, it is our view that the state of Vermont does have the authority to regulate the price at which milk or milk products are purchased and sold within the state of Vermont, whether this be raw milk from the farm to processor or packaged milk products from processor or distributor or the store. We believe that is important that the proposed regulations recognize these limitations in order to be potentially effective.

The buyer and seller will be able to adjust terms of the sale to determine the location of the transaction pursuant to the Uniform Commercial Code. These are realities of the marketplace today. Our cooperatives' experience in Pennsylvania demonstrates that milk handlers and retail buyers will legally devise transactions that occur outside the state regulation and thus avoid the pricing regulations of the regulatory authority, in that case the Pennsylvania Milk Marketing Board. These realities do not mean that a state that has no regulatory authority; but state's regulations must recognize the limits of its authority or they will fail on legal grounds.

Today, for Vermont produced milk and under current terms of trade, the great majority of purchasers occur at the plant processing. In this transaction, the buyer is Class I dealer, and for transactions occurring in Vermont could have a state mandated price enforced for the buyer and seller. However, transactions occurring outside of Vermont cannot be priced. Unfortunately, this represents most of the Class I milk which is eventually purchased by retail outlets in Vermont.

With respect to Section 5.1 of the proposed Order, we have concerns with the proposed distribution of the Vermont Class I pool proceeds through out of state distributors or out of state handlers of fluid milk products distributed in Vermont in two respects. First, to the extent of the distribution of the pool premium proceeds are through the out of state plant, the producers may not benefit at all. In other words, the out of state plant might simply set its producer pay prices lower than it would otherwise and while nominally distributing the Vermont premium to various producers, the net price may be no different than it would have been without premium funds. Secondly, giving priority allocation to the Vermont-sourced milk could be construed as discrimination against interstate milk deliveries. We express the concern in the view of the fact that, at the processing plant, all milk is equal and actual source of the milk delivered back into Vermont cannot be identified. Consequently, to distribute the funds generated by distribution of that product into Vermont to all Vermont producers first, up to the volume of Vermont distribution, could be considered discriminatory to the non-Vermont producers supplying the out of state plant since their commingled milk may have served Vermont consumers as well. It would be our view that the distribution of Vermont pool proceeds would need to be uniformly distributed among all sources of milk at the hypothetical out of state plant.

Another element of concern previously touched on relates to the ability of Vermont to enforce a payment from an out of state plant to out of state producer. We believe it is quite problematic for Vermont to regulate such transactions in another state. As a result, the implementation of Vermont's proposal will likely cannibalize existing competitively derived over-order premiums, and, at best, shift income from producers and other states to producers in Vermont without increasing the amount of income paid to dairy farmers or the region generally.

Finally, the real world marketplace for milk purchases and sales in the region must be taken into account. The Vermont Milk Commission should not be so zealous as to implement a program that creates economic incentives for Class I dealers which are selling milk to retail outlets in Vermont to stop purchasing Vermont milk or stop purchasing from dairy cooperatives. This would occur if the price set is so high in comparison with the out of state price that an in-state handler could profitably incur the costs of acquiring milk or milk products out of state and transporting the milk or milk products to Vermont for sale. To avoid these possibilities, the price of the regulated transactions within Vermont must take into account the market prices outside of Vermont. If the in-state prices do not take into account the level of prices out of state, incentives can be created for transactions to be diverted out of state which would otherwise occur within Vermont. If this occurs, Vermont producers and/or dairies can lose sales and business by virtue of regulations which do not appropriately account for market forces outside the state.

The Cooperatives encourage Vermont to establish a regulation that enables it to price milk with the limits of its authority. In doing so, it is critically important that the regulation which is developed can sustain legally scrutiny. When the appropriate provisions and administration, The Cooperatives believe that Vermont could be successful in implementing a program that carries a premium at a level that would not result in dislocation of Vermont milk supplies and may modestly increase income to dairy farmers. For instance, a state over-order Class I premium for $.50 per hundredweight for purchases in Vermont from Vermont producers would generate perhaps several cents per hundredweight for Vermont farms depending on the volume of the transactions which end up being regulated. As cooperatives, we regret that the higher immediate returns for Vermont state administered price program are not readily available. However, a premium at this level may be sustainable in the marketplace and could even encourage adjoining states to follow suit, which could increase price levels regionally, returning additional dollars to Vermont farms. And we would encourage the

Milk Commission to consider such a regulation.

Happy to answer any questions.

CHAIRMAN ALLBEE: Thank you. Questions?

SENATOR STARR: Yes. Leon, do you know about moving the cost of moving milk? I asked a previous witness what it might cost to move milk.

THE WITNESS: Again, if we were looking at moving assembled milk from one location to another, I'll give you the example of about 250 miles, given the recent fuel prices that we saw this summer, specifically we are talking about $1.35 to $1.50 per hundredweight, somewhere in that range.

CHAIRMAN ALLBEE: For 250 miles.

THE WITNESS: 250 miles. Again, that's assembled milk. Meaning that the tanker is already full at that point, then moving it from that point forward. It doesn't talk about assembling the milk from the farms. That's an additional cost over and above that.

SENATOR STARR: And what might that be?

THE WITNESS: Well, that will range, again, depending on how every organization looks at that specifically. But it could be in the range of $.40 to $.60 per hundredweight depending on the density of your farms and size of your farms. Depends on how you might calculate that.

SENATOR STARR: And so it could, if you had to assemble the milk and then transport it 250 miles, it could cost you $2 a hundredweight.

THE WITNESS: Yes. Depending, again, what's happening with fuel prices and again the size and density of your farm locations.

SENATOR STARR: And 250 miles from Barre, Vermont or Montpelier, how far west does that put you?

THE WITNESS: Well, again, I was using more the location of St. Albans to really beyond the Boston market is what I was looking at. So in terms of going west, I mean, again, one of the challenges, again, as you were discussing early this morning with the Federal Order system, it does not -- it is not cost effective to move milk east to west or west to east because then you don't recover any of those transportation costs within the Federal Order pool.

SENATOR STARR: So the idea of this order displacing Vermont milk with milk from the west, it certainly isn't going to come from the north, and it isn't going to come from the east, and it isn't going to come from the south, so it's got to come, if it comes at all, is from the west. It is not practical.

THE WITNESS: Well, there is, again, definitely milk that is currently supplying the New England market that is outside of New England; and obviously New York is one of those key elements that in terms of moving milk into those New England facilities.

SENATOR STARR: And do you know if there's a new plant being constructed in New York state that might require some of this milk that may be moving east to our area to be relocated to that plant in upper state New York?

THE WITNESS: I'm not sure of the plant that you're discussing in mind.

CHAIRMAN ALLBEE: Upstate New York.

THE WITNESS: Great Lakes, okay. I am aware of that. Again, there's growth with some other facilities as well that might certainly affect direction of milk. And obviously in our situation with the loss of the Saputo Hinesburg facility also has created additional milk available for plants in our region.

SENATOR STARR: Thank you.

MR. HOWRIGAN: I have a couple, Mr. Berthiaume. Over the course of different hearings and testimony it has been referred to by some of the losses as voluntary premium. Did you ever experience any voluntary premium?

THE WITNESS: Again, I would suggest that those premiums are negotiated between the customer and the cooperative and more so not necessarily voluntary in nature but, again, we do come to agreement relative to those additional dollars over and above the minimum uniform price.

MR. HOWRIGAN: Is that agreement to guarantee a supply of milk, for example?

THE WITNESS: It does not necessarily guarantee, again, the supply of milk produced in a particular region. It is to provide the milk that they have requested for their facilities.

MR. HOWRIGAN: Guarantees them a supply.

THE WITNESS: That guarantees them a supply, that's correct.

MR. HOWRIGAN: Is that correct? Guarantee, even though there might be short supply of milk, is that a guaranteed milk production?

THE WITNESS: Well, with regard to as we are talking about Class I, there has been provision in the past that there would be priorities established to provide milk to the Class I fluid outlets over and above manufacturing. And over the course of history we've certainly have had situations where the market administrator has called upon us to provide more milk to the Class I markets versus the manufacturing.

MR. HOWRIGAN: Another question. If the Milk Commission were to establish, and hopefully we can, a premium here, what guarantee do we have that the processors doesn't take it off his so-called voluntary premium?

THE WITNESS: Well, again, as you have heard from other witnesses that have testified, is that, with any program, we want to ensure that this is new monies that would be available to Vermont dairy farmers and that that would not cannibalize existing premiums. And so that is why it is very important as to what we set the level of those premiums and how you might regulate that so that we do not, again, have a negative effect to what we are currently receiving from these customers today.

MR. HOWRIGAN: Do you then have a suggestion how we guarantee that?

THE WITNESS: Well, again, one of the things that I'm suggesting to the Commission this morning on behalf of The Cooperatives is, I think, first and foremost, the important part is establishing the active participation of Vermont Milk Commission in a state-regulated pricing program. Initially to establish it, to address really Vermont milk that's produced, processed and sold within the state. The benefit of that is really to try to get all of our neighboring states to really get involved with the state pricing program, and for us as cooperatives within the Greater Northeast Milk Marketing Agency then really to build on that in trying to establish a higher price that would benefit all dairy farmers within the region.

MR. HOWRIGAN: It was discussed, of course, New York is not part of New England; now is part of the Federal Order covering this area.

THE WITNESS: That is correct. One of the things when you look at Federal Order 1, we have two of the largest dairy states within the Federal Order 1, being both New York and Pennsylvania, that certainly have an impact on the movement of milk and how the various plants throughout this region are served.

MR. HOWRIGAN: Thank you.

CHAIRMAN ALLBEE: Any questions? I got a couple questions just to clarify your remarks.

You indicated that it is the view, I guess, of all the organizations you listed.

THE WITNESS: That's correct.

CHAIRMAN ALLBEE: That the Vermont doesn't have the authority to regulate milk or milk products purchased or sold within the state, whether this be brought milk from the farm to processor or packaged products from the processor.

THE WITNESS: What I'm saying, that you do have the authority to regulate what is produced, processed and sold within the state, yes.

CHAIRMAN ALLBEE: But not outside the state.

THE WITNESS: But not outside the state, that's correct.

CHAIRMAN ALLBEE: The other thing when you talk about Pennsylvania experience, could you elaborate?

THE WITNESS: Well, again, when you look at the Pennsylvania Milk Marketing Board, they are currently pricing milk that's produced, processed and sold within the state. We are actually trying to build on that and trying to get them to deal with the issue of milk that might be moved from one state that has a regulated pricing system to another state so that those premiums would carry through to another state that has an established pricing order. The PMMB has not yet made a decision relative to that, and we are waiting for their decision and their direction on that.

CHAIRMAN ALLBEE: You expect that any day.

THE WITNESS: Again, I can't answer that.

CHAIRMAN ALLBEE: No. Whatever "any day" means. And finally, you say on your last paragraph, the state in an over-order Class I premium of $.50 per hundredweight for purchases in Vermont from Vermont producers would generate perhaps several cents per hundredweight for Vermont farms depending on the volume of transactions which would end up being regulated. Is this a farm gate assessment?

THE WITNESS: No. Again, as you might establish it, again not knowing the specific volumes of the plants here and also the volume that's actually sold within the state, it was really hard to calculate with any certainty what that return might be. But initially, again, the whole thing was really to get the mechanism established.

CHAIRMAN ALLBEE: So it would take place on processors within Vermont?

THE WITNESS: That's correct.

CHAIRMAN ALLBEE: Which there aren't many of.

THE WITNESS: Right, that's correct. Again, the mechanism is what's critical as we try to look beyond just Vermont and really look at something that would, again, potentially build throughout the region recognizing there would never be as uniform as what the Northeast Interstate Dairy Compact has provided us in its past.

CHAIRMAN ALLBEE: I don't know if you were here for Mr. Krupke.

THE WITNESS: For part of his testimony.

CHAIRMAN ALLBEE: He indicated in his testimony that interfering with the Federal Milk Marketing Order system will cause harm to the state's dairy industry. As an alternative to the current proposal we encourage you to convene a study group in Vermont to discuss producers and milk processor distributors in the Northeast Order how to best resolve issues within the Federal Order to benefit the industry. What are the issues, do you know?

THE WITNESS: Well, I mean, certainly there are issues in that, number one, when you look at the Federal Order system and USDA, there really is not established a policy that really addresses regional milk production, number one. And number two, is that the system doesn't really adequately address farmers' cost of production is really the other element that I think is a concern. And then third issue is that there are some issues relative to the manner in which various pricing calculations are performed in terms of establishing the component prices that, again, creates some issues in terms of the ability to get more dollars from the marketplace.

CHAIRMAN ALLBEE: I don't know if you were here when we were asked to give a question from Mike Seaver. It was on cost of production. As you know, when we had Mr. Rasmussen here from the Federal Order last year, we asked him how could they calculate the cost of production. We finally got him, I think, to answer that after bearing down pretty heavily. And he said basically it was a market clearing price. But Mike Seaver's question was: Is it true that the Federal Order directive to establish a cost of production was set to provide fluid milk to consumers since there is only a 40 to 50 percent, I think around 44 or 45 percent, Class I utilization in the Northeast, no risk of running out of milk for fluid use and therefore no need to establish cost of production?

THE WITNESS: Again, obviously, I would look at the larger picture other than just Class I situation and recognizing that ultimately, you know, one of the reasons that the pricing formula was established was to ensure that we would have sufficient milk volumes to meet, again, the needs of consumers. But at the same time those needs go beyond just fluid products today. Obviously in this particular order we have somewhere in the range of 55 percent of our milk that's utilized for manufacturing purposes, and I think that's also in the best interest of consumers is also to have those particular products that are produced here locally for this region. So I would look at that and say that it is important that we understand our dairy industry within the Northeast. We still need to take the issue of the cost of production because it does affect really the viability of our dairy farms, our dairy industry and our ability to maintain viable dairy industry throughout this region.

CHAIRMAN ALLBEE: You list a number of organizations, Green Mountain Federation and that's DFA, Agri-Mark, St. Albans, DMS.

THE WITNESS: Dairylea.

CHAIRMAN ALLBEE: Greater Northeast Milk Marketing Agency.

THE WITNESS: Those have the initial four cooperatives that you just mentioned with three additional cooperatives which would include Maryland-Virginia, Land O' Lakes and Upstate Niagara.

CHAIRMAN ALLBEE: And there was one attempt at some stage to create some sort of over-order premium.

THE WITNESS: Yeah. The initial basis for the Greater Northeast Milk Marketing Agency, one was for the group to come together, especially at a time when there was increasing demand in the marketplace for RBST-free milk, and one was to really establish the pricing mechanism around milk that would be qualified as RBST free. That was the initial one. I think that has continued to be an issue as we continue to see more of a demand now not only from Class I perspective but also from a manufacturing perspective and how do we maintain premiums going forward. And couple other areas that we are looking at is how do we address balancing when we look at the fact that it is the dairy farmers that really have invested into the balancing facilities so that we can continue to serve the needs of all of our customers, whether they be for fluid purposes or for manufacturing. We are also looking at is there a better mechanism as cooperatives within the whole region that we should look at to pricing milk. So that's another element.

The other things that we do look at as a group is what's transpiring within each of the states and ensure that we are working collectively and collaboratively with the states relative to pricing, and that's certainly an element as well as we are very much engaged in what's transpiring with federal orders. One of the elements that, again, this group is looking at is is this a time to really look at Class I deferentials within the region as one element to address some of the things that we have been experiencing. One, higher transportation costs and fuel surcharges have been a real challenge within our region; and that's an area that we are focusing in on.

CHAIRMAN ALLBEE: What's the time frame?

THE WITNESS: Well, right now there has been a request for some additional study and information from our market administrator to really kind of look at some of those. And we should be getting some of that information within the next couple weeks to analyze. And as has been suggested, is that at that point we can always petition the USDA to make changes within the Federal Order system. One of the challenges we have with USDA is the timing in which it takes to have a decision. In the Farm Bill it does address a specific time line, but within that time line it is still fairly lengthy. To give you an example, we have petitioned USDA in December of '06 and still have not received a decision relative to that petition. And that really trying to deal with at that time the increasing energy cost from the farm perspective. And so again, it is a process that certainly needs improvement.

CHAIRMAN ALLBEE: We had representative from the Grocer's Association, Bruce MacDonald, testify this morning and indicated that they probably could support a regional approach but they had problems with a state approach. Do you have any comments with that?

THE WITNESS: Well, again, I can understand certainly the challenge when you look at just Vermonters alone; but I do think we need to start the mechanism and put that in play because we do have other states within the Northeast. Again, we've talked about Pennsylvania and we have referred to Maine in the past. And then ultimately with the hopes that, again, as we continue as Vermont to take a leadership role that we can encourage some of our neighboring states also to again look and complement what we are doing here. Really ultimately bring the full level of premiums higher to dairy farmers in that process.

CHAIRMAN ALLBEE: Do you have any hand on what you figure the cost of production is on farms in your membership?

THE WITNESS: Well, I can only give you, again, just general comments of what I'm hearing versus, again, a specific calculation because I do not have a specific calculation. As you know, it ranges from farm to farm. But certainly the days of $12 milk is certainly gone beyond us; and I would say that in the past this year we were looking at the $18 per hundredweight range as is more often what I heard from our own dairy farmer members.

CHAIRMAN ALLBEE: Are there any programs out there that you are aware of where we call risk management programs?

THE WITNESS: Again, relative to risk management, as a cooperative and with our association with a couple of the other cooperatives we can offer risk management programs to dairy farmer; whether or not they want to, again, forward contract a certain portion of their volume of milk, again depends on, all functions really, what's happening with the markets at any given time. It is certainly one program. Also now there's a new program that I think people are just beginning to get a handle on in trying to come up with a program to really lock in your gross margin as potentially another program.

CHAIRMAN ALLBEE: That's the Farm Bill.

THE WITNESS: Right. So there are a couple of different programs that are out there.

REP. BRAY: Just looking back at what the predecessor of the Milk Commission, the Milk Control Board, were you with the St. Albans Co-op while the Milk Control Board was in operation?

THE WITNESS: I'm not sure that I was.

CHAIRMAN ALLBEE: He's too young.

THE WITNESS: I think as far as I knew, it's always been referred to as Vermont Milk Commission.

MR. SMITH: We're getting old, but we're too young for that.

REP. BRAY: I'm not implying anything. The other -- we talked about farmers being price takers in the marketplace. Wouldn't you say that's in essence that the co-ops themselves are price takers?

THE WITNESS: First of all, in many cases there are limitations that we as cooperatives can ask our customers to pay over and above the announcement minimum price. One of the things as cooperatives we always have the challenge that as processors, especially on the fluid side, they have that opportunity to have a direct relationship with dairy farmers. They do not necessarily need to have their relationship through a cooperative. And so that really limits ourselves to some extent in terms of, again, making sure that we maintain somewhat a competitive premium program so that the milk is not significantly more costly than if they could go out and procure that milk directly with dairy farmers. We do have some limitations.

REP. BRAY: If the farmer were a member of the co-op and left the co-op, are they allowed to leave the co-op in order to sell independently directly?

THE WITNESS: Yes. I mean, majority of the cooperatives have milk marketing agreements that are on an annual basis. So they do have a time of the year where they could make another business decision, say they prefer to have a relationship potentially with a processor.

CHAIRMAN ALLBEE: They have to roll out their equity over a period of time, right?

THE WITNESS: Then again, there are some implications depending on what the cooperative -- again, if you want to talk about equity and other things. Again, that is something they have that annual decision to make as to whether they want to have a different relationship with another cooperative or whether it is independent processor.

REP. BRAY: Thank you.

CHAIRMAN ALLBEE: Other questions?

MR. HOWRIGAN: Just one. You talk a bit about the transportation. And just so I understand, of course, that farmers deliver the milk to the processors. Now with the exorbitant surcharges that are in addition to the ordinary cost, do the processors voluntarily or give any recourse any part of that surcharge back to the cost of the milk?

THE WITNESS: I say there are different circumstances when you look across our customer base and you look at there are some customers that have accepted a program where they will reimburse at least some portion of the additional fuel surcharge. Others, because of the total dollars that we've asked them to pay over and above the announced prices, have suggested that they are still paying more in total. And so we have not necessarily received any additional dollars to compensate for the additional fuel surcharge. And then there are situations when we deal with our plan customers that made those pricing FOBR facilities so that they do cover the full cost of the transportation and surcharge.

MR. HOWRIGAN: Thank you.

MR. SMITH: Leon, couple questions. Wondering if we can refer to Ray's disposition and receipts example to try to flesh out your concerns. If I understand to begin with, your position is that the state through the Commission has the authority to regulate the sales by what Ray's called plant A and plant B for its route disposition for its Vermont sales and its receipts for those sales from Vermont producers. Is that --

THE WITNESS: That's correct?

MR. SMITH: Is there some concern that Booth Brothers, I think we can put some names to some plants since we are not talking plant volume. So we got the Booth Brothers plant that's the big plant and we got a couple one or two smaller plants in Vermont. Is there some concern that Booth Brothers, from your perspective, would, in selling its milk to a supermarket, truck that milk out of state and then somehow adjust transaction out of state to its supermarket customer and then bring the milk back? Does your concern extend that far or?

THE WITNESS: No. But like anything else, I would certainly, again, I think one of the things that we as a state need to be committed to is insuring that we provide the proper environment for our dairy processors to want to be in this state. So the last thing that I would want them to do is to ship more of their production to some other facilities outside of the state. So that would be one of the concerns that I would have.

MR. SMITH: So your concern might be that Hood, owning Booth Brothers, could, from your perspective, move those sales to one of their out of state plants. At that point the transaction between the supermarket customer and Hood is out of state beyond the reach. I'm taking as assumption that your legal conclusion about the state not being able to regulate that out of state sales is accurate. We'll take that assumption. Whether it is accurate or not is another question, but just assuming that that's accurate.

THE WITNESS: Yeah. I think the other issue is really into the partially regulated handlers. Again, I think Ray in his testimony --

MR. SMITH: Sorry. Just from the in-state plants, the concern that you're raising is Booth Brothers would take the milk out, that plant would go out of state but they would divert the entire supply to out of state plant. That's a possibility. Okay. So now you're saying that --

THE WITNESS: Okay. I understood. Then, again, you know, I support around plant D with the premium, you know, again, distribution being over 10 million pounds versus just one, the area we would question when you look at the other plants that have both Vermont and non-Vermont milk, the fact that there would be no distribution on any of the non-Vermont milk would be with the area that would cause concern. Because again, we can't specifically identify that it was strictly just Vermont milk that was used for that container.

MR. SMITH: Okay. So you got an issue of, as you say, giving priority to the Vermont supply to that plant. That's one issue for the out of state plants, but the corollary issue to your concern at the in-state plants is that -- and we are talking basically Hood and Dean plants -- out of state are essentially the supply to -- you're nodding your head yes.

THE WITNESS: Yes.

MR. SMITH: So we've got some variety of two companies in that plant group, and your concern is that Vermont doesn't have the capability to regulate the sales by an out of state plant, say in New York or Massachusetts, to an in-state supermarket chain. So that that regulation, that volume of milk, even though it is included within our pool, from your perspective needs to be excluded because it is beyond the reach of the regulation.

THE WITNESS: That's correct.

MR. SMITH: So that's in essence the pool would be cut by a substantial amount. From that perspective there would be very little of it left.

Now on the other side on the payment side. If I understand what you're saying at the top of page 2, if Vermont is trying to make payments back to the producers, you're saying that the transaction between the plant and the farmer is itself out of state and the state would have no way to enforce the payment. So I don't know if you've had a chance, and I'm not trying to mouse trap you here. We've got ample opportunity for you to take a look at this to get back to us. But to put the issue on the record for your consideration, I've given you a copy of the Proposed Order and I refer you to page 33 of the Proposed Order and the definition in the regulation of a handler. Okay? And if you look down to C, 1.9(c), I'll just read it and you can take a minute to look at it. "Any cooperative association," this is the definition of a handler -- "A, is any person who operates the regulated plant or an exempt plant; B, receives packaged milk." There is some complexity in there that's not relevant. So A is the plant; C is any cooperative association with respect to milk that it receives for its account from the farm of a producer and delivers to a regulated or exempt plant. So, the out of state plant, by definition, is a regulated plant. So by terms of this definition, Leon, the transaction would be from the farmer to the cooperative, not the farmer to the plant. So from that perspective, the transaction would occur on the Vermont farm for the Vermont milk. So if that's the case, and again I'm not asking you off the cuff here, but if you're comfortable responding to that, that's fine; or if you want to come back to us after you had thought about it, whether that alters your assessment, that's my question.

THE WITNESS: Only thing that I guess I would say at this point in time, if I recall at the previous hearing and the testimony that was provided at that time we had concerns with this area of the regulation and the fact that this is an area where we have to negotiate or have to accept the liability and responsibility to the Commission relative to this specific. And then it focuses the responsibility for us to collect that from the Class I processor.

CHAIRMAN ALLBEE: No. The Commission would collect the premium from the processor and disperse the payment to the cooperative as the handler of the milk for the purchases of the milk from the producer as the handler.

THE WITNESS: Okay.

MR. SMITH: I don't mean to put you on the spot. We've got opportunity for filing responsive comments, so if you want to do that, does that make sense?

THE WITNESS: Yes. Sure.

MR. SMITH: Just, you close by, and I'll point you back to our plants A and B. I don't quite get if your concern is legally that the plant, that the in-state plant, Hood/Booth Brothers, could in this dynamic take that milk sale out and put it down in Boston for the in-state process and supplied and consumed in Vermont, what would keep the Hood from just diverting that milk out of state beyond the reach of the state in that instance as well?

THE WITNESS: Certainly would. It is possible.

MR. SMITH: So the affirmity that you described applies to both. So there's very little left from that concern other than the in-state, only in-state cooperatives.

THE WITNESS: Right.

MR. SMITH: And with regard to the purchases -- I'm sorry to jump around on you. I'm going back to the out of state plants. I just wanted to clarify something from a factual standpoint. We've got essentially two milk companies, Hood and Dean Foods, that provide the route disposition in Vermont through some plants. And Ray pointed to some combination of independents and the cooperatives that are supplying those two milk companies. Can you characterize the number of cooperatives that are involved in supplying those plants? How many cooperatives are supplying those? Mr. Krupke referred an out of state milk plant that may or may not be a participant in the market. So if you could comment on just whom is involved in those market transactions with those out of state plants that would be subject to this regulation and its impact.

THE WITNESS: Again, in addition to the independent producers that potentially supply these facilities, the majority of the cooperatives would be Agri-Mark, St. Albans, DFA, and Dairylea would be the key cooperatives that would be, again, supplying the milk to these facilities.

MR. SMITH: And the cooperatives other than Agri-Mark are operating through a common agency to market the milk to the plants; is that accurate?

THE WITNESS: Yes. I mean, there's three cooperatives, Dairy Farmers America, Dairylea and St. Albans that work under the umbrella of Dairy Market Services which is, again, an effort to work collaboratively in pricing the delivery of milk to our customers.

MR. SMITH: Would DMS would be the handler to those milk sales to DMS joint companies, and Agri-Mark operates outside of that to its customers. So we have two, in essence, cooperative handlers.

THE WITNESS: Two key, again, entities that are providing the greatest amount of volume to these facilities.

MR. SMITH: And is their reach of those -- is the reach of those two cooperatives beyond New England into Pennsylvania and the other areas where companies might choose to finesse the regulation? So wouldn't a plant that was trying to finesse the regulation in the manner Mr. Krupke described still run into DMS and/or Agri-Mark; or at that point are there other sources of milk that Mr. Krupke's example might bring in? That's my question. Or are we still dealing with the same marketplace wherever you go?

THE WITNESS: As you move into, again, whether it is into parts of New York and Pennsylvania, then you're, again, adding the additional cooperatives that we mentioned under the scenario which, again, would be the Maryland-Virginia, Upstate Niagara as well as Land O' Lakes.

MR. SMITH: How far out of the source plants for Vermont do you have to move until you run into those additional cooperatives besides DMS and Agri-mark?

THE WITNESS: As we move into, again, either southwestern part of New York and Pennsylvania is where it you would be.

MR. SMITH: So would it help us, Mr. Trucker. How many miles are we talking about right there to refer you back? 400 miles?

SENATOR STARR: Yeah, you're talking 800.

THE WITNESS: Depends. Whether you're coming from the Syracuse direction or whether you're coming down below, you could be, again, 250 to 500 miles depending on where we are talking about.

MR. SMITH: DMS and Agri-Mark reach to that point, and then you're into the boundary of the milk shed at that point? Okay. Thanks.

CHAIRMAN ALLBEE: Good. Thank you. Obviously it is open to provide more information. There's lunch out there for the Commission members.

Bob, did you have something to say, too?

MR. WELLINGTON: (Agri-Mark) I have some information I have to share for the --

MR. SMITH: Did you want to put it into the record for Proposed Order hearing or just make it available to the Commission independent of the hearing?

MR. WELLINGTON: Make it available to the Commission.

MR. SMITH: So we can close the hearing.

CHAIRMAN ALLBEE: Just a moment. Put some stuff on the record.

MR. SMITH: Documents on the record. We need to document that, under Section 2(d)(1) the hearing was noticed in the newspapers of record and by correspondence under 2(d)(2) to the list of interested persons that the Commission keeps. And I'll mark those as the appropriate exhibits for addition in the record.

And last, we need to notice that correspondence was made to the appropriate officials of the other New England states and New York and Pennsylvania. And that's been done and I will put that in the record as well.

CHAIRMAN ALLBEE: So noted. So we will close the hearing at this point.

MR. SMITH: Yeah, just one comment and it follows the suggestion I made to Leon, that the Commission has -- the Commission's procedural rules allow participants in the hearing to provide proposed findings and conclusions based on the evidence. So the transcript of today's hearing, including Ray's example, will be available by Friday. And if any of the participants would like to comment further on any of the evidence, and I would to some extent point to the examples that Ray's provided and make proposed finding, further proposed findings and conclusions, that provision is in the regulation for that purpose to allow further comment on the evidence that's come in. And finally, anybody can provide written comment in addition to that. So there is yet over the next two weeks the ability to provide further comment on these issues to complete the record.

CHAIRMAN ALLBEE: And so we close the hearing.

(Hearing concluded at 12:42 p.m.)

CERTIFICATE

I hereby certify that the foregoing is a true and accurate transcript, to the best of my skill and ability, from my stenographic notes of this proceeding.

_________ ___________________________________

Date Jane Worthen Eaton, RMR, CRR, CMRS
Registered Professional Reporter and
Notary Public

My commission expires February 10, 2011