

VOLUME I

BEFORE THE SECRETARY OF
THE UNITED STATES DEPARTMENT OF AGRICULTURE
AGRICULTURAL MARKETING SERVICE

In the Matter of Proposed Amendments: : Docket Number
to Tentative Marketing Agreements : : A0-14-A74, et al
and Orders : : DA-06-01

National Public Hearing
January 24, 2006
Sheridan Suites
801 North St. Asaph Street
Alexandria, Virginia 22314

BEFORE:

PETER M. DAVENPORT
U.S. ADMINISTRATIVE JUDGE
UNITED STATES DEPARTMENT OF AGRICULTURE

1 APEARANCES:

2 On Behalf of United States Department of Agriculture:

3 Sharlene Deskins

4 Babak Rastgoufard

5 Jack Rower

6 Henry H. Schaefer

7 Jason Nierman

8 Erin Taylor

9 On Behalf of Agri-Mark:

10 John Vetne

11 Robert Wellington

12 Richard Langworthy

13 On Behalf of National Cheese Institute:

14 Steven Rosenbaum

15 On Behalf of Select Milk Producers, Continental Dairy

16 Products and Dairy Producers of New Mexico:

17 Benjamin Yale

18 Ryan Miltner

19 Kristine H. Reed

20 On Behalf of the Association of Dairy Cooperatives in the

21 Northeast:

22 Marvin Beshore

23 On Behalf of the National Cheese Institute:

24 Steven Rosenbaum

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6	Copy of appendix referenced in the preliminary analysis contained in Exhibit No. 1		
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1 January 24, 2006, 8:30 a.m.

2 THE JUDGE: Good morning, and
3 welcome to the National Public Hearing. I'm
4 Judge Davenport. The -- this national
5 hearing is being held to consider and take
6 evidence on proposal seeking to amend the
7 Class III and Class IV milk price formula
8 manufacturing allowances applicable to all
9 federal milk marketing orders. Evidence
10 will also be taken at the hearing to
11 determine whether emergency marketing
12 conditions exist that would warrant omission
13 of a recommended decision under the rules of
14 practice.

15 The purpose of the hearing is to
16 receive evidence with respect to the
17 economic and marketing conditions which
18 relate to the proposed amendments which have
19 been set forth and any appropriate
20 modifications thereof to the tentative
21 marketing agreements and to orders.

1 Just a few housekeeping things. We
2 are under fairly cramped quarters. We are
3 going to see at the break, in other words,
4 how many folks actually are going to be here
5 and whether or not we can get additional
6 tables or whether we are going to have to
7 leave the seats as they are.

8 If anyone is going to power up their
9 notebooks, why don't you go ahead do that
10 now. Let me also ask you if you would turn
11 your cell phones either to silent or to
12 vibrate so that you are not disturbing other
13 people during the course of the hearing.

14 The restrooms are around the corner.
15 We will be taking breaks throughout the day.
16 If there is a need for a break, in other
17 words, if you will communicate that to me.

18 In the past it's also my desire and
19 expectation that if we have dairy farmers
20 that are present, in other words, and they
21 have time constraints, we try to make sure

1 that they are heard, in other words, as
2 early as possible so that they can get to
3 back and tend to business. So in other
4 words, subject to that, the schedule may be
5 interrupted here and there.

6 I'm told that the microphones, all
7 you have to do is power them on at this
8 point. And I'll adjust the one for the
9 witness as well.

10 Ms. Deskins, I guess I'll call upon
11 you at this time to enter your appearance
12 and introduce the people with you and, in
13 other words, we can start taking, in other
14 words, the standard exhibits which accompany
15 the notice.

16 MS. DESKINS: Thank you, Judge
17 Davenport. I'm going to try to turn this
18 microphone on.

19 Maybe that's not going to work.

20 THE JUDGE: Okay. You want to try
21 again.

1 MS. DESKINS: It's on now. My name
2 is Sharlene Deskins. I'm an attorney with
3 the United States Department of Agriculture,
4 Office of General Counsel. I represent the
5 Agricultural Marketing Service in this
6 hearing, and I'm going to hand the
7 microphone to my colleague, who will enter
8 his own appearance.

9 MR. RASTGOUFARD: Babak Rastgoufard,
10 also with the Office of General Counsel.

11 MR. ROWER: Thank you, Judge
12 Davenport. I'm Jack Rower. I'm a marketing
13 specialist with the Agricultural Marketing
14 Service.

15 MR. SCHAEFER: Henry Schaefer, Upper
16 Midwest Marketing Area, Minneapolis,
17 Economist.

18 MR. NIERMAN: Jason Nierman,
19 Agricultural Economist, Appalachian
20 Marketing Area, Louisville, Kentucky.

21 MS. TAYLOR: Erin Taylor, a marketing

1 specialist with AMS Dairy Programs.

2 MR. YALE: Your Honor, before we
3 begin, I would like to, first of all,
4 introduce myself. I'm Benjamin Yale on
5 behalf of Select Milk Producers, Continental
6 Dairy Products and Dairy Producers of New
7 Mexico.

8 We wish to enter an objection to the
9 hearing and the limited notice of hearing to
10 the fact that it is limited only to the price
11 -- Class III and IV milk price formula
12 manufacturing allowances; that the failure of
13 the Department to consider and enter into a
14 recognition of the rest of the formulas,
15 which are the yields and the pricing series,
16 is, in and of itself, an arbitrary and
17 capricious decision, and that this hearing
18 should consider all aspects of the formula,
19 not just the make allowance. We'd just
20 enter our objection on that. It's going to
21 be a continuing objection to the proceeding.

1 THE JUDGE: Your objection will be
2 noted.

3 MS. DESKINS: Judge Davenport, would
4 you like us to proceed with the exhibits?

5 THE JUDGE: Yes, ma'am.

6 MR. RASTGOUFARD: I have some
7 preliminary exhibits that I would like to
8 enter into the record. These are
9 notification documents pursuant to the -- I
10 would like to enter into the record pursuant
11 to 7 CFR, 900.4(c).

12 [Handing out documents.]

13 I will just repeat myself. I have
14 some preliminary exhibits that I would like
15 to enter into the record. These are
16 essentially notification documents that I
17 would like to enter into the record pursuant
18 to 7 CFR 900.4(c). There are 12 such
19 documents.

20 The first document is a copy of a
21 hearing notice published in the Federal

1 Register on January 5th, 2006. This is 7 Fed
2 Reg 545.

3 The second exhibit is a copy of the
4 appendix which is referenced in the
5 preliminary analysis contained in Exhibit 1.
6 One of our witnesses later today, Howard
7 McDowell, will discuss this analysis later
8 this morning.

9 Exhibit 3 is a copy of the January
10 4th, 2006, press release regarding today's
11 hearing.

12 Exhibit 4 is a certification of the
13 notice given to state governors of today's
14 hearing.

15 Exhibit 5 is a certification of
16 mailing of notice to interested parties known
17 to the Market Administrator of the Southwest
18 Order.

19 Exhibit 6 is a certification of
20 mailing of notice to interested parties known
21 to the Market Administrator of the South --

1 excuse me, of the Central Order. I'm sorry.

2 Exhibit 7 is a certification of
3 mailing of notice to interested parties known
4 to the Market Administrator of the Upper
5 Midwest Order.

6 Exhibit 8 is certification of mailing
7 of notice to interested parties known to the
8 Market Administrator of the Southeast Order.

9 THE JUDGE: And Florida.

10 MR. RASTGOUFARD: And Florida.

11 Sorry, Southeast and Florida Orders.

12 Exhibit 9 is a certification of
13 mailing of notice to interested parties known
14 to the Market Administrator of the
15 Appalachian Order.

16 Exhibit 10 is a certification of
17 mailing of notice to interested parties known
18 to the Market Administrator of the Northeast
19 Order.

20 Exhibit 11 is a certification of
21 mailing of notice to interested parties known

1 to the Market Administrator of the Mideast
2 Marketing Area.

3 And Exhibit 12 is a certification of
4 mailing of notice to interested parties known
5 to the Market Administrator of the Pacific
6 Northwest and Arizona-Las Vegas Order.

7 That concludes our list of
8 preliminary exhibits.

9 [Whereupon, Exhibits 1 through 12
10 were marked for identification by the judge.]

11 THE JUDGE: Very well. Exhibits 1
12 through 12 have been marked.

13 Are there objections? They will be
14 admitted into evidence at this time.

15 [Whereupon, Exhibits 1 through 12
16 were received in evidence.]

17 MR. RASTGOUFARD: We would like to
18 present our first witness, John Rourke.
19 Whereupon,

20 JOHN ROURKE,
21 called on behalf of the USDA, having been

1 first sworn by the judge, was examined and
2 testified under oath as follows.

3 THE JUDGE: Tell us your name and, if
4 you would, spell it for the hearing
5 reporter.

6 THE WITNESS: My name is John Rourke,
7 R-O-U-R-K-E.

8 DIRECT EXAMINATION

9 BY MR. RASTGOUFARD:

10 Q. Good morning, Mr. Rourke.

11 A. Good morning.

12 Q. Can you please state for the record
13 your job title and employer?

14 A. I am the Chief of the Market
15 Information Branch and Dairy Programs,
16 Agricultural Market Service, USDA.

17 Q. Thank you. And can you please state
18 your duties in that capacity?

19 A. I have overall responsibility for
20 the direction of the "National Market News"
21 program and the National Federal Milk Order

1 Statistics program.

2 Q. Can you please describe your
3 background in dairy?

4 A. I have been Chief of the Market
5 Information Branch since 1991, and I have
6 been employed by Dairy Programs and its
7 predecessor organizations since 1970.

8 Q. Thank you. And also for the record,
9 could you please describe your educational
10 background.

11 A. I have a B.S. degree in economics
12 from the University of Maryland, and I did
13 postgraduate work at the master's level in
14 agricultural economics at Pennsylvania State
15 University.

16 Q. And you have testified at previous
17 Federal order hearings before?

18 A. Yes, I have.

19 Q. Testifying at such orders such as
20 the one today is part of your duties?

21 A. Yes, it is.

1 Q. And in those past hearings, you have
2 been entered information into the record of
3 those hearings?

4 A. Yes, I have.

5 Q. Were you asked to prepare any
6 information for the hearing today?

7 A. Yes, I was.

8 Q. And did you bring that information
9 with you?

10 A. Yes, I did.

11 Q. And can you please describe for
12 everyone what you have brought with you
13 today?

14 A. Yes. We received a request from the
15 industry to recompute uniform prices for each
16 of our orders using five different sets of
17 make allowance, different sets of make
18 allowances. Each of the offices recomputed
19 their prices using the actual pounds of milk
20 pooled during the months, the utilization
21 percentages and other factors used to

1 compute uniform prices, and then the -- also
2 using the recalculated class prices
3 resulting from the different sets of make
4 allowances.

5 And then these offices submitted
6 their information to Washington, and we
7 summarized this information into the
8 documents that I will be presenting today.

9 Q. The documents and the recalculations
10 that you just described, who prepared the
11 document and recalculations?

12 A. The documents that I'll be
13 presenting today were prepared under my
14 supervision, the documents that are in the
15 exhibit today.

16 Q. Okay. Thank you. And the data
17 contained in the exhibits in the tables, can
18 you describe where that data was obtained?

19 A. The data in the tables came from
20 each of the individual Market Administrator
21 offices. Each office submitted a separate

1 report, and we summarized them into these
2 tables.

3 Q. And the data that was submitted,
4 these are official USDA records?

5 A. That's correct.

6 Q. And who asked you to prepare this
7 information?

8 A. The request came from Mr. Ryan
9 Miltner, who is with the Yale Law Office.

10 Q. And did you have any other requests
11 in conjunction with today's hearing?

12 A. No, we did not.

13 Q. And so, the information that you are
14 about to enter into the record is -- excuse
15 me, prepared pursuant to the request that you
16 received from the Yale Law Firm?

17 A. That is correct.

18 Q. I understand you prepared a
19 statement that you would like to enter into
20 the record?

21 A. Yes, I have.

1 Q. Are you prepared to read that
2 statement at this time?

3 A. Yes, I am.

4 STATEMENT FOR THE RECORD BY JOHN ROURKE

5 My name is John Rourke. I am chief
6 of the Market Information Branch in Dairy
7 Programs of the Agricultural Marketing
8 Service of the U.S. Department of
9 Agriculture. I have been the Chief of MIB
10 since 1991 and have been employed by Dairy
11 Programs and its predecessor organization
12 since 1970.

13 This testimony is made not in favor
14 of any of the proposals being considered at
15 this hearing. This testimony is prepared in
16 response to a request from a hearing
17 participant as follows. A copy of this
18 request is shown on page 2 of this document.
19 Each federal milk order Market Administrator
20 received a request to recompute uniform
21 prices for 2004 and 2005 using several make

1 allowance options. These include the three
2 scenarios in the hearing notice and two more
3 supplied by the requestor. These are shown
4 below. We have labeled these five options
5 Scenarios 1, 2 and 3 to coincide with the
6 scenarios in the hearing notice and the two
7 from the requestor have been labeled Option 1
8 and Option 2. For each option for each
9 month the plants(class) and component prices
10 were recomputed and the uniform prices were
11 recalculated using these recomputed prices
12 and the same pool pounds, utilization
13 percentages and pool adjustment factors as
14 were in place during the actual pool
15 computation. Each MA office did the
16 calculations for their orders and submitted
17 the results to me. I have provided a
18 standard reporting format and have prepared
19 the attached tables.

20 Pages 3 through 6 of this document
21 show the recalculated basic class price

1 information for each of the five make
2 allowance options, along with the actual
3 class price information by month January of
4 2004 through December of 2005. Also included
5 are two year averages and comparisons.

6 Pages 7 through 16 of this document
7 contain the results of the recomputed
8 uniform prices. Shown for each of the 10
9 current orders are the actual uniform price
10 and the recomputed uniform price using a
11 make allowances in each of the five options
12 by month for January 2004 through December
13 2005. Also included are two year averages
14 and comparisons. For the orders that use
15 the component prices system for paying
16 producers, the figures are the statistical
17 uniform price which is the sum of the Class
18 III price and the producer price
19 differential. For orders that use the skim
20 milk butter fat system, prices system for
21 paying producer, the figures are the sum of

1 the uniform butter fat price times 3.5 and
2 uniform skim milk price times 0.965.

3 This concludes my prepared
4 statement.

5 Q. Thank you. Can you also walk us
6 through the tables that are attached?

7 A. Yes, I can. Page 2 is a photocopy
8 of the e-mail request from Mr. Miltner
9 requesting the computation recomputation of
10 the uniform prices.

11 Pages 3 through 6 show the
12 recalculated basic class price information
13 using the five different sets of make
14 allowances, as well as the actual prices. If
15 you look at page 3, again, the figures shown
16 on this table are in dollars per
17 hundredweight, 3.5 percent butter fat.
18 January 2004, for example, the actual Class I
19 base price was \$11.85. Under Scenario 1 the
20 Class I base price would have been \$11.64;
21 under Scenario 2, \$11.49, et cetera, across

1 the page.

2 At the bottom of the page we have
3 the two-year averages of the actual Class I
4 prices in each of the Class I prices
5 resulting from the five make allowance
6 options. Those two-year averages are simple
7 averages. The last row of information is a
8 statistic that we have labeled the
9 difference, and that is the difference
10 between each of the make allowance options
11 and the actual numbers. So, for example,
12 under Scenario 1, the two-year average was
13 \$14.48, which was 21 cents lower than the
14 actual Class I base price.

15 Similar information is shown on the
16 following pages for Class II, Class III and
17 Class IV.

18 Beginning on page 7 through 16, we
19 have shown the recomputed uniform prices for
20 each of the 10 orders currently in effect,
21 one page per order. Again, we show the

1 actual uniform price computed for the month
2 and what the uniform price would have been
3 for the month under each of the five make
4 allowance sets of options. These figures,
5 again, are in dollars per hundredweight, 3.5
6 percent butter fat and for the principal
7 pricing point of the order.

8 Looking at January 2004, the actual
9 uniform price was \$13.58 per hundredweight.
10 Under Scenario 1, the uniform price would
11 have been \$13.33; Scenario 3, \$13.23, and so
12 forth across the top of the table.

13 At the bottom of the table, again we
14 have a two-year average. These, again, are
15 simple averages of the actual uniform price
16 for the two-year period and each of the
17 uniform prices computed under the five sets
18 of make allowances.

19 We also have a statistic labeled a
20 difference, and this again is the difference
21 between the uniform -- two-year average

1 uniform price for each of the five sets of
2 make allowance options compared to the actual
3 uniform price two-year average. For example,
4 for under Scenario 1, the two-year average
5 would have been \$15.81, which would be 26
6 cents lower than the two-year average of the
7 actual uniform prices.

8 Similar information is then shown on
9 the following pages for the other nine
10 orders.

11 Q. Thank you. Is there anything else
12 you would like to add about these
13 recalculations?

14 A. Not at this time.

15 MR. RASTGOUFARD: If I may, I would
16 like to move this document into the record
17 as Exhibit 13.

18 THE JUDGE: So entered.

19 [Whereupon, Exhibit No. 13
20 was received in evidence.]

21 BY MR. RASTGOUFARD:

1 Q. Mr. Rourke, with your analysis which
2 is now in the record as Exhibit 13, was it
3 submitted for or against the proposal that's
4 been proposed to the Secretary?

5 THE JUDGE: That's contained in the
6 statement, counsel.

7 MR. RASTGOUFARD: Okay. I have no
8 further questions.

9 THE JUDGE: Cross? Mr. Vetne?

10 Mr. Vetne, if you would, enter your
11 appearance and spell your last name for the
12 hearing reporter.

13 MR. VETNE: My name is John Vetne.
14 V-E-T-N-E. I'm an attorney. My office is in
15 Newberry Port, Massachusetts. I represent
16 the proponent Agri-Mark and Northwest Dairy
17 Association.

18 EXAMINATION

19 BY MR. VETNE:

20 Q. Mr. Rourke, I note that these
21 recalculations are for the same pool pounds

1 that were originally reported. You are aware
2 that, particularly in 2004, there was
3 considerable volume of milk that wasn't
4 pooled during some months, but it was pooled
5 during others. Am I correct that, in
6 recalculating, you made no attempt to capture
7 the milk that wasn't pooled nor to analyze
8 whether such milk would have been pooled
9 under the revisions?

10 A. That is correct.

11 Q. And although the -- under the
12 recalculations, although the classified price
13 for Class III and IV products changed as
14 well as Class I and II, you made no effort
15 in your recalculations to analyze or
16 identify any market response to those
17 pricing changes; is that correct?

18 A. That is correct.

19 Q. And when you refer to the uniform
20 price or the statistical uniform price in
21 your testimony, you are, based on the

1 recalculations, without market response, you
2 are only referring to that portion of
3 producer revenue that is derived from
4 regulated prices?

5 A. That is correct.

6 Q. There is also producer revenue that
7 -- information that your office gathers that
8 is not part of regulated prices; is that
9 correct?

10 A. That is correct.

11 Q. Mailbox prices?

12 A. Correct.

13 Q. And mailbox prices are reported and
14 published by the Dairy Programs?

15 A. That is correct.

16 Q. And the mailbox prices include the
17 uniform price plus whatever premium is paid.
18 Does the -- is that correct?

19 A. And other things.

20 Q. And other things. Describe the
21 other things that are in there so we know.

1 A. Mailbox price is the price received
2 by farmers at their farm gate, which would
3 include any over-order payments, premiums, as
4 you called them, and less any cost incurred
5 in marketing their milk, such as hauling
6 charges, co-op dues, et cetera.

7 Q. So the reported mailbox price
8 represents the total price received minus the
9 hauling cost charged to producers?

10 A. And other marketing --

11 Q. And other things as well?

12 A. Yes.

13 Q. Okay. And the uniform price does
14 not reflect a subtraction for the producer's
15 hauling cost from farm gate to plant?

16 A. That is correct.

17 Q. And the difference between the
18 uniform price and the mailbox price varies
19 from market to market and month to month; is
20 that correct?

21 A. That is correct.

1 Q. Were you asked to make or attempt to
2 make any conclusions with respect to the
3 impact of the proposals on the mailbox price
4 received by producers in the average market
5 as reported by Dairy Programs?

6 A. No, we were not.

7 Q. You refer to these proposals in your
8 uniform price exhibit as applying to the
9 principal pricing point. What is the
10 significance of that limitation?

11 A. The normal point at which we publish
12 prices is the -- each order has a --
13 referred to as a principal pricing point.
14 The uniform prices vary across the orders,
15 depending on the -- prices vary across the
16 orders based on the pricing point of the
17 milk. So we report -- we uniformly report
18 the prices that -- at a point that we call a
19 principal pricing point in the order, and
20 those are specified in the order.

21 Q. Okay. Let's look, for example, at

1 the Northeast on page 7 of the tables. All
2 of the numbers in the first column of
3 numbers, which is headed, Actual, are uniform
4 prices at the principal pricing point?

5 A. That is correct.

6 Q. And the principal pricing point in
7 the Northeast is --

8 A. Suffolk County, Massachusetts.

9 Q. Which is Boston?

10 A. Boston.

11 Q. And most of the milk is produced
12 outside of Suffolk County?

13 A. I assume that to be correct.

14 Q. You also gathered data on where milk
15 is produced that is pooled?

16 A. Yes, we did.

17 Q. And most of it is produced in
18 Vermont, New York and elsewhere, at some
19 distance from Boston, correct?

20 A. That is correct, although it may be
21 marketed in Boston.

1 Q. It may be marketed in Boston, but it
2 is priced at the plant its first received,
3 correct?

4 A. Correct.

5 Q. Does it make a difference to anybody
6 where the pricing point is for purposes of
7 the line labeled, Difference?

8 A. I would think that the figures shown
9 under Difference would be the same regardless
10 of the pricing point.

11 Q. All right. The numbers under the
12 uniform prices may be different from your
13 table, but the actual versus Scenario 1,
14 whatever, should be the same?

15 A. I would expect so.

16 Q. In your endeavor, did you observe or
17 attempt to observe whether the relationship
18 between the uniform prices and the new class
19 prices would tend to either encourage or
20 discourage voluntary repooling so that the
21 numbers pooled would be different from what

1 you viewed?

2 A. No, we did not.

3 Q. Are you familiar with the economic
4 premise that when prices for a good drop,
5 consumers tend to respond by buying more?

6 A. Yes, I am.

7 Q. And in each of the scenarios, the --
8 this regulated portion of the price for
9 product dropped. Did you attempt to observe
10 or make any observations of the impact of
11 increasing consumer demand as a result of the
12 price drop?

13 A. No, we did not.

14 Q. And are you also familiar with the
15 economic premise that when -- in response to
16 a demand increase, prices go back up again?

17 A. Yes.

18 Q. And again, no observation or attempt
19 to make an observation of that was
20 incorporated in your data?

21 A. No, it was not.

1 THE JUDGE: Mr. Yale.

2 Mr. Yale, please identify yourself
3 again.

4 MR. YALE: Sure. Ben Yale on behalf
5 of Select Milk, Continental Dairy Products
6 and Dairy Producers of New Mexico.

7 EXAMINATION

8 BY MR. YALE:

9 Q. First of all, Mr. Rourke, I want
10 to thank you for putting this information
11 together on such short order and also, I
12 guess, indirectly, to all the Market
13 Administrators who did that. Thank you very
14 much.

15 Mr. Vetne asked you some
16 questions about the mailbox price. This is
17 one of the statistics that is put together
18 by the Department; is that correct?

19 A. That is correct.

20 Q. And it is made available to the
21 public on a monthly basis -- several-month

1 lag, but on a monthly basis?

2 A. Yes, sir.

3 Q. We have -- I don't have them stapled
4 together. There are two different documents
5 we would like to have marked as an exhibit.

6 THE JUDGE: Would you like them
7 separately marked or --

8 MR. YALE: Let's mark them
9 separately because we don't have them
10 stapled.

11 THE JUDGE: Very well. They will
12 be Exhibits 14 and 15.

13 MR. YALE: And we have a number
14 of copies here. We'll try to accommodate as
15 many as we can.

16 The first one, Exhibit 14 is the --
17 14 is the 2003-2004 mailbox price. And then
18 15 would be 2005 through October -- or
19 September. I'm sorry.

20 THE JUDGE: That will be marked as
21 15, or 14.

1 MR. YALE: Yes, that's 14. Here's
2 15.

3 [Whereupon, Exhibits No. 14
4 and 15 were marked for identification by the
5 judge.]

6 BY MR. YALE:

7 Q. Mr. Rourke, let me represent, I
8 printed this off. You can see it is prepared
9 by the Mideast Market Administrator's
10 Office. These are published at various --
11 they are online at various sites; is that
12 correct?

13 A. Yes, they are.

14 Q. And does this look like the
15 information that is put together by the
16 USDA?

17 A. Yes, it does.

18 Q. Now, you -- in answer to a question
19 of Mr. Vetne's, you tried to explain what
20 this reflected. And that is explained in
21 Footnote No. 1 on both of these tables, is

1 it not?

2 A. That is correct.

3 MR. YALE: Your Honor, we would move
4 for the admission of Exhibits 14 and 15.

5 THE JUDGE: Objection? There being
6 no objection, 14 and 15 will be admitted
7 into evidence at this time.

8 [Whereupon, Exhibits No. 14
9 and 15 were received in evidence.]

10 BY MR. YALE:

11 Q. Now, Mr. Rourke, you also indicated
12 the methodology to determine these uniform
13 prices. And as explained in the regulations,
14 behind these uniform prices are individual
15 class prices. And each of those individual
16 class prices are based upon various
17 component prices, depending on the order. Is
18 that correct?

19 A. Yes. Class I prices are dependent
20 upon the order, yes.

21 Q. Right. And the Department -- first

1 of all, is part of your responsibility also
2 the website that USDA has with the
3 information that's presented, or is that
4 somebody else's -- under AMS Dairy --

5 A. Under Marketing Order Statistics web
6 page, yes.

7 Q. Okay.

8 A. That part of it, yes.

9 Q. All right. And does that include
10 the link that provides for the price
11 formulas?

12 A. Correct.

13 MR. YALE: Your Honor, we'd like to
14 have marked as Exhibit No. 16 the pricing
15 formulas.

16 [Whereupon, Exhibit No. 16
17 was marked for identification by the judge.]

18 BY MR. YALE:

19 Q. Mr. Rourke, I have put in front of
20 you what's been marked as Exhibit 16. Have
21 you had a chance to look through that?

1 A. Yes, I have.

2 Q. And what is Exhibit 16?

3 A. Exhibit 16 shows by year the price
4 formulas that are in the -- each of the
5 orders for establishing the minimum class
6 prices and component prices under the order.

7 Q. And this -- these are the formulas
8 that were used -- well, first of all, let's
9 look at these formulas. And the key ones I
10 want to point out are Class III and IV. I
11 mean, you would agree with me, would you
12 not, that Class I and II are the III or IV
13 formulas plus some factor for Class II and
14 the --

15 THE JUDGE: Mr. Yale, excuse me for
16 interrupting.

17 MR. YALE: Yes.

18 THE JUDGE: In other words, why don't
19 you have him identify for what years.

20 BY MR. YALE:

21 Q. Okay, yes, would you please

1 identify what years this represents, each of
2 these pages.

3 MR. YALE: Thank you, Your Honor.

4 THE WITNESS: The formulas are shown
5 for 2000, 2001, 2002, 2003, 2004, 2005 and
6 2006.

7 BY MR. YALE:

8 Q. Thank you.

9 Let's look at the Class I formula
10 that's indicated on -- for 2006, this is a
11 function, a direct function, is it not, of
12 either the Class III or Class IV price
13 formula, depending upon which is the higher?

14 A. That is correct.

15 Q. And Class II is a direct function of
16 the formula used to derive the Class IV
17 formula; is that correct?

18 A. That is correct.

19 Q. So by that, I mean, if you were to
20 raise by just a discrete amount, say, a
21 penny or a dime, either the Class III or

1 Class IV price, you would see a corresponding
2 increase for that penny or dime exactly in
3 the Class I and Class II formulas. Is that
4 correct?

5 A. Well, I would point out that the
6 time period used for the prices is different
7 between the Class I skim milk and butterfat
8 and Class II skim milk and from Class III and
9 IV. So assuming that the one cent occurred
10 in both time periods, that would be correct.

11 Q. Right. Thank you.

12 Now, so with that in mind, looking
13 at Class III, you will notice that we have
14 -- it is derived from three components, is it
15 not?

16 A. Correct.

17 Q. And there is a separate formula for
18 each of the protein, the other solids and
19 butterfat prices?

20 A. That is correct.

21 Q. Okay. Now, part of this formula for

1 the protein price is the cheese price; is
2 that correct?

3 A. Correct.

4 Q. And what is the cheese price that's
5 used for this part of the formula?

6 A. The cheese price that we use is the
7 -- we use both a price -- the prices are
8 collected by the National Agricultural
9 Statistic Service. They collect weekly
10 prices. The two products that we use are --
11 for the cheese price are the price for a
12 40-pound block and 500-pound barrels, the
13 U.S. average.

14 Q. And this is a weighted average that
15 is computed for each month; is that right?

16 A. Right. NASS reports weekly
17 prices, and we compute monthly averages based
18 on four or five weeks, depending on the time
19 period.

20 Q. And then for the Class I and Class
21 II -- Class II. You don't use Class III.

1 But for Class I, if it's involved, you just
2 look at two of these, right?

3 A. That is correct.

4 Q. All right. And then there is a --
5 this next number, it says minus 0.165. What
6 is that .165?

7 A. That is the make allowance.

8 Q. Okay. And then what is the --

9 A. I'm sorry, 165 -- yes, make
10 allowance. Yes.

11 Q. And then there is a 1.383. And what
12 is that number?

13 A. That's the yield factor.

14 Q. Okay. And we see again a cheese --
15 same cheese price, right, used in the next
16 part of the formula that you just described,
17 as we proceed to the right, as we go across?

18 A. That is correct.

19 Q. And then we have it again, that 165
20 again, is that the make allowance?

21 A. That is correct.

1 Q. And then we have, what, another
2 yield?

3 A. That is correct.

4 Q. Do you know what the difference
5 between why -- what the two different yields
6 are?

7 A. I think the second yield has to do
8 with the -- I believe it has to do with the
9 yield of the cheese from butterfat.

10 Q. Okay. And then the first one would
11 be the yield of cheese from protein? I'm not
12 trying to put you on the spot.

13 A. It's from milk. Yes.

14 Q. Okay. And then we have the
15 butterfat price. And we'll talk about that
16 in a minute, because that's what relates down
17 here to the third component in
18 this, right? Isn't that correct?

19 A. Correct.

20 Q. All right. And do you know what the
21 .9 represents?

1 A. I believe that is the recovery of
2 butterfat in cheese.

3 Q. Okay. And if you know the answer to
4 what the 117 is, that's fine.

5 A. I don't recall what that is.

6 Q. Okay.

7 Now, let's got to the next -- the
8 other solids price, a little bit simpler
9 formula. We have a dry weight price. At
10 what -- what is the dry weight price?

11 A. Again, that is a price series
12 collected by NASS, weekly price that we
13 weight to a monthly average.

14 Q. Okay. And then the .159?

15 A. That's a make allowance.

16 Q. And the 1.03?

17 A. I believe that's a factor to adjust
18 for whey solid. I don't recall what that's
19 for.

20 Q. Okay. And then we move down here to
21 the butter price, butterfat price, and we

1 have butter price. And what is that?

2 A. Again, that is a monthly average of
3 the weekly prices collected by NASS.

4 Q. And the .115?

5 A. That's the make allowance.

6 Q. And then the 1.20?

7 A. That's a conversion factor from
8 butter to butterfat.

9 Q. Could that also be considered the
10 yield of butter, how much butter one gets
11 from --

12 A. Butterfat, yes.

13 Q. Now, because these -- we have these
14 formulas in here, you would agree, would you
15 not, that any change in the cheese price --
16 because it does change from day to day, week
17 to week; is that correct?

18 A. Generally.

19 Q. Yes. So any change in that would
20 have a change in the protein price?

21 A. Correct.

1 Q. All right. And similarly, any
2 change in the make allowance would have an
3 impact in the change in the protein price?

4 A. Correct.

5 Q. And any change in either of these
6 yields would have a change in the protein
7 price; is that correct?

8 A. Correct.

9 Q. And then looking down here at the
10 other solids, we have the same situation. A
11 change in the dry weight price could change
12 the other solids price, correct?

13 A. Correct.

14 Q. And a change in the make or yield
15 would have a similar impact in changing that
16 price; is that right?

17 A. Would have a change in price, yes.

18 Q. Right. And we could say the same
19 for the butterfat, right?

20 A. Correct.

21 Q. Okay. Now, going back to the

1 exhibit that you presented with the various
2 scenarios and options, and you asked people
3 to make changes in their formulas -- or not
4 people. You asked the Market Administrators
5 to recompute class and uniform prices. Which
6 of these factors for Class III was changed to
7 derive those particular formulas? Do you
8 know?

9 A. The make allowance of parts of each
10 of the formulas is what was changed.

11 Q. There was no change in the cheese
12 price?

13 A. Correct.

14 Q. And there was no change in yields?

15 A. Correct.

16 Q. Or any of the other prices, dry whey
17 or butterfat or butter price, right?

18 A. Correct.

19 Q. Now, moving down here, then, to
20 Class IV, and we come down and it's a
21 function of the nonfat solids price, and we

1 see nonfat dry milk price. What is that?

2 A. Again, that is a monthly average of
3 the weekly NASS prices computed by AMS.

4 Q. And the .14 is?

5 A. Make allowance.

6 Q. And then the .99?

7 A. The conversion factor from -- of
8 nonfat solids.

9 Q. And the same question again, when
10 you asked them to recompute the Class IV
11 price, what change did you ask them to -- did
12 those various options and scenarios, what did
13 they change?

14 A. The only factor that was changed was
15 the make allowance.

16 Q. Okay. And, of course, this would
17 then have an impact on the Class II or Class
18 I prices based upon these changes in the
19 formulas in the same way; is that right?

20 A. That's basically correct, based --
21 based on the time --

1 Q. Right.

2 A. -- period, but these are average
3 product prices.

4 Q. Now, if you would, turn to the
5 formula for 2002 as an example. And if you
6 would, if you can, maybe get them so you can
7 compare that to the one that we just talked
8 about for 2006. And I want to look down
9 here at the protein price.

10 And, unfortunately, these things
11 are numbers one of two, one of two, one of
12 two. So it is the one labeled 2002 compared
13 to the 2006. And I want to look at the
14 protein formula. And you will note, would
15 you not, that the make allowance is the same,
16 but there is a difference in the yield there
17 from 1.383 to 1.405; is that right?

18 A. Correct.

19 Q. And the same thing over there
20 between the 1.572 in 2006 and 1.582 for
21 2002; is that right?

1 A. Correct.

2 Q. And other changes, there is no
3 factor .9 on the butterfat price, and the
4 1.28 is different than the 1.17, right?

5 A. Correct.

6 Q. So there are changes that are made,
7 there have been made to these formulas other
8 than the make allowances, is that correct,
9 over a period of time?

10 A. That is correct.

11 Q. Now, you indicated, I think, during
12 your direct examination, that you are
13 involved in the publication of "Dairy Market
14 News"?

15 A. That is correct.

16 MR. YALE: Your Honor, we would like
17 to have marked as Exhibit 17, and it is the
18 week of January 9 through 13, 2006, "Dairy
19 Market News," Volume 73, Report No. 2.

20 [Whereupon, Exhibit No. 17 was marked
21 for identification by the judge.]

1 BY MR. YALE:

2 Q. Do you have in front of you, Mr.
3 Rourke, Exhibit No. 17?

4 A. Yes, I do.

5 Q. And could you identify that
6 yourself?

7 A. This is the weekly report generated
8 by the operation of the Market News Program
9 that's put together in the field office in
10 Madison, Wisconsin.

11 Q. Could you explain for the record
12 what the "Dairy Market News" -- first of
13 all, how often is it published?

14 A. This particular report is published
15 weekly. The information in the report,
16 generally, is also weekly information,
17 although for some prices, it's more than
18 weekly.

19 Q. Okay. And this is a report
20 routinely produced by the Department?

21 A. Yes.

1 Q. And it is used by the Department and
2 the dairy industry as reliable information
3 for whatever purposes that they use in
4 dairy?

5 A. Yes, sir.

6 Q. Now, I would like to go through --
7 there are a couple parts of this that I
8 would like to pay particular attention to.
9 If you would, look at pages 7 through 8.
10 And if you could, please explain what these
11 pages are.

12 A. These pages are monthly averages for
13 each month of 2005 of the various weekly
14 price series that are collected under Market
15 News.

16 Q. And ordinarily, this would be
17 published each week, is that correct, for
18 the week, the information for that
19 particular week in the particular issue?
20 This is the annual summary; is that correct?

21 A. Correct.

1 Q. And ordinarily, it's done on a
2 weekly basis?

3 A. The averages for a month are
4 published in one of these weekly reports.

5 Q. Okay. Thank you. And then, also, I
6 would like you to look to page 13. Could
7 you identify that, please.

8 A. Another data series that we collect.
9 In the Market Information Branch is a data
10 series on announced cooperative Class I
11 prices for various city markets in our
12 Federal milk orders. We would publish a
13 monthly price, again, in these various weekly
14 reports, and this particular table is the --
15 where we show the annual averages of those
16 monthly prices.

17 Q. This is in response in part to one
18 of the questions of Mr. Vetne, that there
19 are additional monies that milk is sold for
20 in addition to minimum prices; is that
21 correct?

1 A. This would be one measure of that,
2 yes.

3 Q. Now, this isn't an actual weighted
4 average of what plants actually pay for
5 milk. This is based upon the announced
6 prices by the cooperatives?

7 A. That is correct.

8 Q. I want -- sorry, I want to go back
9 -- or not -- let's go to the beginning.

10 There are a couple of other points I
11 just want to identify into the record of
12 interest that we are developing.

13 If you look at the bottom of page
14 2, and do you -- what is that table?

15 A. The bottom table, it's identified as
16 NASS Dairy Product Prices. These are the
17 actual weekly prices that were collected by
18 the National Agricultural Statistic Service
19 for the week ending January 7th and would
20 have been released on January the 13th,
21 actual prices for that week.

1 Q. And these are the prices that we had
2 talked about earlier dealing with the
3 product formulas, right? These are the
4 prices that go into those formulas or they
5 contribute to them?

6 A. That would be correct, although they
7 may be -- actual prices used for this week
8 may not be those that are shown on this
9 page, depending on what was published the
10 next week.

11 Q. There are revisions from time to
12 time?

13 A. Right.

14 Q. And I think you note down here that
15 the final revisions are found on a
16 particular website; is that correct?

17 A. Correct.

18 MR. YALE: And, in fact, Your Honor,
19 we would like to have judicial notice taken
20 of the website listed at the bottom of page
21 2, and particularly for the years 2004 and

1 2005. This is information provided by the
2 National Agricultural Statistical Service
3 and is used as part of the formulas that are
4 going to be in discussion at this hearing.

5 THE JUDGE: Mr. Beshore.

6 MR. BESHORE: Marvin Beshore,
7 representing the Association of Dairy
8 Cooperatives in the Northeast. I think we
9 need more precision if we are going to be
10 taking official notice of any publications
11 on web pages. And I think Mr. Yale's
12 statements was just, you know, of a web page
13 cited at the bottom of that. And it changes
14 daily or frequently. So we need more
15 precision if we are going to be asked to
16 take notice of such publications.

17 MR. YALE: In response to that, Your
18 Honor, it is my understanding that the ones
19 that would be at this website with a back
20 slash 2004 and back slash 2005, I believe,
21 is correct. Or is it -- I may have to

1 modify that, but there are two specific
2 website pages, although dairy will get you
3 to all the years since 1998. BY MR. YALE:

4 Q. Do you recall, Mr. Rourke, what that
5 address is? I mean, any more specific?

6 A. No, I don't.

7 MR. YALE: It may be DPR 2005, but
8 I'll get you that specific one to allow for
9 that notice.

10 THE JUDGE: All right. Why don't you
11 Let me a very specific reference --

12 MR. YALE: We'll do that.

13 THE JUDGE: -- and then we'll take it
14 from there.

15 BY MR. YALE:

16 Q. Now, was there any other --

17 MR. YALE: I want to change topics
18 here a second. We are done with Exhibit 17
19 which, by the way, we would move to admit
20 Exhibit 17.

21 THE JUDGE: Objection?

1 MR. YALE: And we'd also move to
2 admit Exhibit 16. I don't think I moved
3 that in. That's the formulas.

4 THE JUDGE: Exhibits 14 through 17
5 will be admitted at this time.

6 [Whereupon, Exhibits No. 14
7 through 17 were received in evidence.]

8 MR. YALE: And at the same time, Your
9 Honor, we would request that official notice
10 be taken of the publication, "Dairy Market
11 News," for each of the weeks of 2004 through
12 the briefing period that would be -- after
13 this hearing is ended.

14 THE JUDGE: Mr. Vetne.

15 MR. VETNE: John Vetne representing
16 Agri-Mark. I don't have an objection as to
17 the reliability of information reported in
18 the "Dairy Market News." It contains its
19 own qualifications and footnotes.

20 However, I do have a problem with
21 official notice of the -- I mean, we just

1 have one week here, and we are looking for
2 104 publications over two years. It's a lot
3 of information.

4 Without identification of the
5 specific data series that Mr. Yale is
6 interested in, I would object, because I
7 don't want to have to guess what to use, what
8 to look for here, when I write a brief.

9 MR. YALE: Your Honor, this
10 information has routinely been allowed into
11 the Federal orders. It is information,
12 public record. It's published by the
13 Department referencing the situation going on
14 in the dairy industry.

15 I mean, I can -- you know, we have
16 identified several schedules in here, but
17 there are other tables in here that are
18 going to be relevant and may be identified
19 as the hearing progresses.

20 THE JUDGE: I agree that this
21 information is generally available. It's

1 generally considered to be the type of
2 information that the secretary can look at
3 for whatever weight he wishes to give it. So
4 at this time, I'll will take notice of the
5 fact that the publication does exist and may
6 be drawn upon during the briefing portion.

7 Yes, sir?

8 MR. RASTGOUFARD: I just wanted to
9 object to the inclusion of future
10 publications, i.e, those publications that
11 have not yet been published and not taking
12 judicial notice of anything that doesn't yet
13 exist.

14 MR. YALE: We'll take it up through
15 the -- there will be a publication yet this
16 week, I think, through the 14th. I mean,
17 there will be -- this one is through the
18 13th. There will be one more publication
19 this Friday. Huh? Well, the hearing is
20 still on.

21 The question was whether it would be

1 future, but that's still -- the hearing is
2 still on, Your Honor, so if we could at
3 least bring it through the -- the report, I
4 believe -- would that be Report 04 or 03?

5 THE WITNESS: Report 3.

6 MR. YALE: Report 3 through 2006.

7 And we'll end it there. We won't go
8 anything beyond that.

9 THE JUDGE: Very well.

10 THE WITNESS: Actually, it will be
11 Report 4.

12 MR. YALE: Okay. I thought so. I
13 pulled this off Thursday.

14 BY MR. YALE:

15 Q. Moving on, then, I want to change
16 topics to another issue dealing with
17 information that is also available out
18 there. There is also made available,
19 produced by NASS, information regarding the
20 herd size by state and the production and
21 number of operations in various -- in some

1 of the states. Are you aware of that?

2 A. Yes, I am.

3 Q. But that's not information put
4 together by AMS?

5 A. No, it is not.

6 Q. From time to time, you report
7 summaries of that information in "Dairy
8 Market News," do you not?

9 A. That is correct.

10 Q. Now, prior to this hearing, you got
11 a request from our office for this table to
12 be prepared, which we appreciated. You got
13 also another request, did you not, from us
14 that you were unable to comply with because
15 of the time constraint?

16 A. Yes, that is correct.

17 Q. And what was that?

18 A. The request was for -- another dated
19 series that's collected is producer of milk
20 marketed under the orders by state and
21 county. We normally assemble that

1 information for the months of May and
2 December. I believe you requested that
3 information for May and December of 2000
4 through 2005.

5 You also requested information on the
6 -- by -- by county for producers that were
7 smaller than 5 million pounds of milk
8 marketed during the month, I think, for the
9 most recent time period that might be
10 available. And then you also asked for
11 copies of annual summaries of Federal milk
12 orders, the statistics for 2000 through
13 2005.

14 Q. Let's talk about that last one.
15 You indicated that that information is
16 available on the web, is it not?

17 A. Yes, the complete summaries for
18 2000 through 2004 are available on the web,
19 on our website. The complete summary for
20 2005 is not completed, but most of the
21 statistics are out there, and the general

1 format, that would be an annual summary.

2 Q. And what is the title of each of
3 those documents?

4 A. Federal Milk Order Market
5 Statistics, and it would be the annual
6 summary, 2000 annual summary, 2001 annual
7 summary through 2005.

8 MR. YALE: Your Honor, we would
9 request, then, official notice be taken of
10 the federal milk order statistics for 2004
11 and 2005 as they are on the website, and we
12 could have official notice taken of those
13 statistics, the annual summaries.

14 THE JUDGE: There appears to be
15 no objection.

16 BY MR. YALE:

17 Q. And then one final issue that I
18 wanted to discuss with you. Mr. Vetne asked
19 you a hypothetical, that if there is a
20 change in price, there will be a response in
21 production and -- or in supply and demand,

1 is that -- that's kind of basic economics,
2 right?

3 A. Yes.

4 Q. Now, over the years, you have -- you
5 observe -- you just don't report these
6 documents. You observe them and start to
7 kind of, you know, absorb what they are
8 telling you, do you not?

9 A. I attempt to, yes.

10 Q. Because part of your job is also to
11 give information to other people within the
12 Department that may make policy decisions
13 and other decisions and reports; is that
14 correct?

15 A. That is correct.

16 Q. Now, if prices -- producer prices
17 are to drop, what is the expectation that
18 the response would be on supply?

19 A. If producer prices were to drop,
20 then you would expect supply to drop, milk
21 production to drop.

1 Q. And how does milk production drop?
2 Is this done in a uniform basis or is it
3 done in, you know, bits and pieces
4 throughout the country or patchwork? How
5 would you describe it?

6 A. I don't know if I have done that
7 much of an analysis, but I would not expect
8 it to be the same across the country.

9 Q. And does it tend to be more in
10 response by smaller or larger producers?

11 A. I have not made that kind of
12 observation.

13 Q. There was one other area I forgot
14 that I did want to point out. When you look
15 at Exhibits 14 and 15 again, as well as the
16 exhibit that you prepared at our request,
17 these are done by individual marketing
18 areas, are they not?

19 A. The mailbox prices are for reporting
20 areas in Federal milk orders.

21 Q. Right. And this does not include

1 the entire nation?

2 A. That is correct.

3 Q. Approximately what percent of
4 the milk is reflected in these Federal order
5 statistics that's produced nationwide?

6 A. In the normal pooling under the
7 orders, it would be somewhere in the
8 neighborhood of -- on the average, 65 to 70
9 percent, depending on pooling of all the
10 milk.

11 MR. YALE: Your Honor, I have no
12 more questions at this time. Thank you very
13 much. And again, thank you, Mr. Rourke, for
14 cooperating with those exhibits.

15 THE JUDGE: It is about quarter
16 of 10:00. This might be a logical time to go
17 ahead and schedule our morning break. It's
18 -- what's your pleasure, 15 minutes? Very
19 well. Let's resume at 10 o'clock.

20 [Whereupon, the hearing
21 recessed at 9:46 a.m. and reconvened at

1 10:08 a.m.]

2 THE JUDGE: We are back in
3 session. Is there other cross of Mr.
4 Rourke? Mr. Beshore.

5 Ladies and gentlemen, if you will
6 go ahead and take your seats. Let's give
7 them just another second.

8 MR. BESHORE: Marvin Beshore.

9 EXAMINATION

10 BY MR. BESHORE:

11 Q. Mr. Rourke, you are familiar with
12 the MILC program, the lost contract program?

13 A. Yes.

14 Q. Is the income the dairy farms
15 receive when that program is applicable and
16 months when it is respected, is that
17 reflected in the mailbox milk price series,
18 Exhibits 14 and 15?

19 A. Those payments are not included in
20 the mailbox prices.

21 Q. Are they included in the uniform

1 price calculations in Exhibit 13?

2 A. No, they are not.

3 Q. Do you have an FMLS annual?

4 A. Yes, I do.

5 Q. Could you possibly identify the
6 tables if they are -- if they are in that --
7 in the annual, and I think they may be,
8 which -- which would give us the utilization
9 factors and other factors that you used in
10 recomputing uniform prices in Exhibit 13?

11 In other words, at the bottom of the
12 first page of Exhibit 13, you indicated in
13 summary how those prices were recalculated.
14 But there would have been for -- in each
15 order, the class utilization percentages
16 would have been part of that calculation, I
17 assume?

18 A. That is correct. The additional
19 factors that were used in the computation,
20 recomputations that would appear in the
21 annual summary would be the class

1 utilization percentages.

2 Q. But what table is that?

3 A. The 2004 summary. Class I is on
4 Table 14. Class II is Table 18. Class III
5 is Table 22. And Class IV is Table 27.

6 Q. So the percentages reflected in each
7 of those tables for each order would have
8 been utilized at the uniform price
9 recalculations?

10 A. Well, they would have used actual
11 pounds of milk. So the actual pounds of
12 milk used in the political classes are also
13 shown in those tables.

14 Q. Are they in the same numbered
15 tables?

16 A. Actual pounds of milk are on Tables
17 13 for Class I; 17 for Class II; 21 for
18 Class III; and 26 for Class IV.

19 Q. And those are the -- in the 2004
20 annual, correct?

21 A. That is correct.

1 Q. Now, if we wanted to find the same
2 numbers for the 2005 months that were used
3 in making the calculations on Exhibit 13,
4 where would we find that information?

5 A. Those would be on our milk marketing
6 or the statistics web page. If you look
7 under the 2005 annual summary, make some
8 statement about it being under development
9 or something along those lines, and there
10 would be similarly numbered tables having the
11 information for 2005.

12 I don't know for sure if it's the
13 exact same table number, but the information
14 would be there.

15 Q. Okay. So that -- although that full
16 publication is still under construction,
17 those -- the information in those tables is
18 available on that web page?

19 A. For all of 2005, yes.

20 Q. For all of 2005.

21 MR. BESHORE: I would like to

1 request that official notice be taken of
2 those series that Mr. Rourke has just
3 referenced.

4 THE JUDGE: Very well.

5 THE WITNESS: None of the other
6 factors that were used in the calculations
7 would be in our annual summary.

8 BY MR. BESHORE:

9 Q. What other factors are there other
10 than those enumerated on 13?

11 A. There are other factors such as
12 location adjustments, overages and things.
13 One-half of the unobligated balance is part
14 of the pool computation.

15 Q. So in calculating 13, your staff, or
16 Market Administrator staffs, actually
17 recalculated the pool, in essence, in each
18 order?

19 A. Well, they recomputed the uniform
20 price, using actual information that was
21 resulting of the pooling process for the

1 month.

2 Q. I would like you to look at Exhibit
3 16 just for a minute. And I call your
4 attention to the formula for Class III that
5 Mr. Yale took you through these numbers
6 somewhat, took you through this calculation.

7 I do not see anywhere in the Class
8 III price formula the advanced Class III
9 skim milk pricing factor.

10 Am I missing it or is it just not
11 there?

12 A. If you look up under Class I, there
13 is a note there that talks about the advance
14 pricing factors and the formulas that they
15 used.

16 Q. But it is a different number than
17 any calculation in the Class III formula
18 itself, isn't that correct?

19 A. The result of running a formula will
20 generate a different number.

21 Q. And the same thing for Class IV,

1 when you calculate the Class IV price, you
2 do not calculate an advanced Class IV
3 pricing factor, correct?

4 A. When we compute the Class IV price,
5 we do not compute an advanced pricing factor
6 for Class IV skim milk. That is correct.

7 Q. So when you recalculated Class I and
8 Class II prices in Exhibit 13, you had to --
9 didn't just use the recalculated Class III
10 and Class IV prices, you had to make an
11 additional assumption, and that is that --
12 or make an additional calculation. You had
13 to calculate the advanced Class III and IV
14 and the advanced butter fat pricing factors
15 that are part of the Class I and Class II
16 formulas, correct?

17 A. That is correct. All of the
18 formulas were rerun for the 2004 and 2005
19 period, using the 5 cents make allowances.

20 Q. Thank you.

21 THE JUDGE: Mr. Vetne?

1 EXAMINATION

2 BY MR. VETNE:

3 Q. Just a couple of follow-up to other
4 cross.

5 Mr. Rourke, Ben Yale asked you a
6 question concerning producer supply response
7 to lower prices, do you recall that? And
8 your answer was, well, Economics 101, if
9 prices are lower, supply would drop.

10 A. I recall that.

11 Q. Okay. Rather than freezing the
12 frame at that point, when supplies drop,
13 what, under Economics 101, do you expect to
14 happen to prices thereafter?

15 A. Well, when supplies drop, depending
16 on what happens to demand, if the demand
17 stays the same or grows up, increases due to
18 lower prices, and eventually milk production
19 will increase.

20 Q. And that is the cycle that you have
21 observed in dairy, is that not correct?

1 Prices drop, supplies drop, and because
2 supplies drop, prices increase, production
3 goes up?

4 A. That would be correct. I have
5 observed that.

6 Q. Couple questions about the mailbox
7 prices here. You indicated that these do
8 not include the milk -- the co-op payments
9 to producers. Do the mailbox prices that
10 you report include or not include
11 cooperative dividends checks, thirteenth
12 checks, that kind of thing?

13 A. They do not include thirteenth
14 checks, cooperative dividends.

15 Q. Okay. And those are two terms for
16 essentially the same thing, thirteenth check
17 and dividends, or similar things?

18 A. I probably would not agree with
19 that.

20 Q. What is the difference? They both
21 are not included. What is the difference

1 between a thirteenth check and a dividend?

2 A. A thirteenth check, I believe, is,
3 from previous observations, I haven't
4 observed that much of late, would be a --
5 generally a payment resulting from
6 cooperative operations during the year.

7 Q. All right.

8 A. I don't know if a dividend is
9 necessarily the same thing, but --

10 Q. In any event, it doesn't include the
11 -- the mailbox prices don't include those?

12 A. That is correct.

13 Q. So if someone wanted to convert the
14 mailbox prices to the gross receipts of
15 producers for milk produced, one would have
16 add dividends or thirteenth check, one would
17 also have to add hauling, and one would have
18 to add dues and other things to come to a
19 figure of gross revenue for the sale number?

20 A. That is correct.

21 Q. Are there any data sources that you

1 are familiar with that would provide that
2 information?

3 A. Not that I'm aware of.

4 MR. BESHORE: That's all. Thank you.

5 THE JUDGE: Yes, sir.

6 EXAMINATION

7 BY MR. ROSENBAUM:

8 Q. Good morning. Steven Rosenbaum for
9 the National Cheese Institute.

10 I just have a couple follow-up
11 questions about the formulas that Mr.
12 Beshore asked you about. And this is, I
13 guess, with respect to Exhibit 16.

14 Now, the formulas are set forth --
15 are correctly set forth for Class III and
16 Class IV on this page, correct? Those are
17 the formulas in effect today, correct?

18 A. Yes.

19 Q. For 2006?

20 A. Yes.

21 Q. So that was a yes?

1 A. Yes, for 2006.

2 Q. And when it comes to pricing Class I
3 and Class II, I'm oversimplifying slightly,
4 but you look at what the Class III price and
5 what the Class IV price, and you add a
6 differential on top, correct?

7 A. We use the Class III and Class IV
8 prices for the -- computed for the advance
9 pricing term period based on two-week
10 averages.

11 Q. Okay. And what I want to focus in
12 on is that the formula that is used for
13 determining the advanced pricing is the same
14 formula as set forth here for Classes III
15 and IV except that you use a different time
16 period for determining the skim milk price,
17 the protein price, the other solids price and
18 the butterfat price; is that correct?

19 A. Correct. We use a different time
20 period for the product prices that are used
21 in the formulas.

1 Q. But the formulas themselves are
2 otherwise exactly the same, correct?

3 A. Correct.

4 MR. ROSENBAUM: That's all.

5 THE JUDGE: Mr. Yale.

6 EXAMINATION

7 BY MR. YALE:

8 Q. I want to follow up on the question
9 about the revenue. Do you understand the
10 MILC program, how it is computed?

11 A. Yes, I do.

12 Q. And how is that computed?

13 A. They compare the Class I price in
14 Boston or in the principal pricing point of
15 the Northeast Order, Class I price in
16 Boston, compared to a target level, which
17 is, I believe, 1694. They take that
18 difference, and under the old -- the program
19 that has expired, they would multiply that
20 difference by 45 percent and pay it out to
21 dairy farmers who have applied for payments

1 based on their pounds of milk --

2 Q. At this point, the renewal of that
3 has not passed; is that correct?

4 A. That is correct.

5 Q. Now, in addition to the -- you know,
6 the 45 or whatever the percentage may be,
7 there is also a limit to how much money a
8 producer can receive, right?

9 A. I'm not aware of --

10 Q. There is a cap of the amount of --
11 you are not aware of a cap on production in
12 excess of 24,000 hundredweight or anything
13 like that?

14 A. Yes. I'm aware of that, yes. I
15 thought you meant payment.

16 Q. No. I'm sorry. I guess I misstated
17 it. The cap on the pounds that are eligible
18 for payment?

19 A. Correct.

20 Q. All right. Now, in the Federal
21 order program, the uniform prices that you

1 have given us in your Exhibit 13, is there
2 anywhere in there in which that a producer
3 reaches a point, if his production gets so
4 high, that he is not eligible for that
5 uniform price?

6 A. No.

7 Q. And there was a question about the
8 revenues from co-op dividends, I think, or
9 thirteenth check, or however Mr. Vetne --
10 that there was some additional revenues from
11 the co-ops as separate from the production,
12 payments for the production, right, or
13 whether co-ops sometimes make those payments,
14 right?

15 A. It's separate from their normal
16 monthly payment.

17 Q. Right. And do you see information
18 regarding those payments and how those
19 payments are made and the like? Are you
20 aware, generally, of the basis of those
21 payments?

1 A. I see anecdotal information. It
2 certainly would not be representative of the
3 whole population.

4 Q. But in that anecdotal
5 information, first of all, could you answer
6 yes or no whether or not a payment from a
7 co-op, whether it goes only to its members
8 or those who it's purchased milk from, or
9 does it go to everybody in the marketing
10 area?

11 A. It would be my understanding it goes
12 to their members.

13 Q. And their members only?

14 A. That would be my understanding, yes.

15 Q. And are you also aware of whether or
16 not the distribution of the profits is based
17 upon the producers production or a formula
18 that might include ownership or some other
19 factor other than production for that year?

20 A. I don't recall using the word
21 profits, but I think the payment is based --

1 my understanding is it's based on
2 production.

3 MR. YALE: That's all I have. Thank
4 you.

5 THE JUDGE: Other questions? Very
6 well, Mr. Rourke, you may step down.

7 MS. DESKINS: Mr. Davenport, our next
8 witness is Dr. Charles Ling.

9 THE JUDGE: Very well. Dr. Ling,
10 will you come forward.

11 Whereupon,

12 DR. CHARLES LING,
13 called on behalf of the USDA, having been
14 first sworn by the judge, was examined and
15 testified under oath as follows.

16 THE JUDGE: Please be seated and give
17 us your name and spell your name for the
18 hearing reporter.

19 THE WITNESS: My name is Charles
20 Ling, L-I-N-G.

21 EXAMINATION

1 BY MS. DESKINS:

2 Q. Dr. Ling, it is my understanding
3 that your statement is being passed out?

4 A. That is correct.

5 Q. Dr. Ling, you have prepared a
6 statement today?

7 A. Yes.

8 MS. DESKINS: Your Honor, could we
9 have that marked as -- I believe we're --

10 THE JUDGE: It's No. 18.

11 MS. DESKINS: Yes, sir.

12 [Whereupon, Exhibit No. 18
13 was marked for identification by the judge.]

14 BY MS. DESKINS:

15 Q. Would you like to read from that
16 statement now, Dr. Ling?

17 A. Yes, okay.

18 STATEMENT FOR THE RECORD OF CHARLES LING

19 My name is Charles Ling. I am an
20 agricultural economist with Cooperative
21 Programs of Rural Development. I have served

1 as its program leader for dairy, livestock
2 and poultry since 1988. Five years prior to
3 joining Cooperative Programs in 1978 I was
4 an agricultural economist with the Federal
5 Milk Order No. 2 Market Administrator's
6 office in New York. I received my BS degree
7 from National Taiwan University and master's
8 and Ph.D. from University of Connecticut,
9 all in agricultural economics.

10 I am testifying for the record at the
11 request of the Agricultural Marketing
12 Service regarding the results of a technical
13 assistance study of the cost of
14 manufacturing dairy products at a number of
15 dairy cooperative plants for 2004.

16 After publishing dairy product manufacturing
17 costs at Cooperative Plants, ACS Research
18 Report No. 34, in 1983 a group of
19 cooperatives requested the then Agricultural
20 Cooperative Service, ACS, to conduct an
21 annual confidential technical assistance

1 project to help in their cost comparisons.
2 The cooperatives promised to provide data
3 from selected plants to ACS for the use in
4 for use in developing a database of cost
5 information from large cooperative milk
6 manufacturing plants. ACS would provide
7 each cooperative with the report comparing
8 particular cooperative's plants with other
9 similar plants without disclosing individual
10 plant data to others. Participation in the
11 study is voluntary and is open to all dairy
12 cooperatives. The 2004 plant cost study was
13 the 20th year of the technical assistance
14 project.

15 Cooperative programs is authorized by
16 the Cooperative Marketing Act of 1926 to
17 conduct technical assistance studies.
18 Section 3(b) of the act directs it, To make
19 surveys and analyses if deemed advisable of
20 the accounts and business practices of
21 representative cooperative associations upon

1 their request; to report to the association
2 so surveyed the results thereof, and with
3 the consent of the association so surveyed
4 to publish summaries of the results of such
5 surveys together with similar facts, for the
6 guidance of cooperative associations and for
7 the purpose of assisting cooperative
8 associations in developing methods of
9 business and market analysis.

10 That's in section, that is 7 USC
11 section 453.

12 For the plant cost comparison
13 technical assistance project, dairy
14 products studied are butter, nonfat dry
15 milk, usually called powder cheese and, if
16 data are available, whey and other dairy
17 products. Only in-plant costs are included.

18 The following instructions were given
19 to the cooperatives for report cost data on
20 butter-powder plants.

21 No. 1. Scope of cost information.

1 In-plant costs of moving milk from the
2 receiving deck to the product delivery deck.
3 Exclude milk procurement costs,
4 transportation, administrative costs, plant,
5 office plant manager and corporate overhead,
6 interest and cost associated with facilities
7 for prolonged storage or off-site storage.

8 No. 2. Milk received at the plant
9 incurred as a receiving cost. Cream and
10 skim separated in the plant incur the costs
11 of receiving and separating milk. Condensed
12 skim incurs an additional evaporation cost.
13 If milk, cream, skim or condensed was
14 shipped out of the plant, please ensure the
15 accompanied receiving, separation or
16 evaporation and shipping costs are taken out
17 of plant manufacturing cost.

18 3. If cream, skim or condensed was
19 received at the plant for further
20 processing, allocate a cost to the that
21 product as if it had been separated or

1 condensed at the plant. Cost incurred at the
2 receiving bay should be noted also.

3 4. For direct cost items such as
4 direct labor, electricity and fuels, please
5 ensure the dollars and physical units
6 reported correspond with each other.

7 For reporting cost data on cheese
8 plants, these two instructions replace the
9 previous items 2 and 3:

10 1. If cream, skim, condensed, skim
11 or condensed whey or other intermediate
12 product was received at or shipped out of
13 the plant please make sure the product is
14 allocated a processing cost. Costs incurred
15 at the receiving bay for receiving/shipping
16 the product also should be noted.

17 2. Do not include the cost of
18 processing whey and whey product in cheese
19 manufacturing costs.

20 Nine cooperatives submitted 2004 cost
21 data on 17 cheese plants, 8 butter plants

1 and 16 powder plants. However, due to data
2 incompatibility, one butter plant and two
3 powder plants were not included in the
4 database for preparing the final report. A
5 set of nine reports was prepared; each
6 participating cooperative received a report
7 comparing its plant cost with the average of
8 all plants making the same product. These
9 reports, like all technical assistance
10 reports, carry this disclaimer:

11 This technical assistance report was
12 prepared for the sole use of, name of
13 (cooperative). Its board of management may
14 make any use of the report they deem
15 appropriate but cooperative programs will
16 treat it as confidential to the extent
17 provided for by law.

18 With the consent of the participating
19 cooperatives, the results of study are
20 summarized and presented in the accompanying
21 table. Simple average plan costs were

1 14.267 cents per pounds of all cheeses,
2 17.019 cents per pound for 40-pound block
3 cheese, 6.721 cents per pound of condensed
4 whey solids, 11.545 cents per pound of dried
5 whey, 18.137 cents for pounds butter and
6 21.417 cents per pound of powder. Using
7 each plant's product volume as the weight,
8 the weighted average costs were 13.295 cents
9 per pound of all cheeses, 15.136 cents per
10 pound of 40-pound block cheese, 6.549 cents
11 per pound of condensed whey solids, 11.409
12 cent per pound of dried whey, 16.588 cents
13 per pound of butter and 16.816 cents per
14 pound of powder.

15 In reviewing these cost data, several
16 factors have to be kept in mind.

17 1. Cost analysis does not consider
18 differences in product quality. Products of
19 higher quality conceivably would require
20 higher quality ingredients and more effort
21 by labor.

1 2. Cost allocation procedure for
2 multi-product plan may not be uniform among
3 the participating cooperatives; therefore,
4 two plants having exactly the same operations
5 and same total costs may show different unit
6 product manufacturing costs.

7 3. The nature of a plant might affect
8 its cost. A plant used strictly for
9 manufacturing purposes tends to have a
10 relatively constant milk volume and is
11 operated at a high rate of capacity. It is
12 likely to have a lower cost than a plant for
13 balancing milk supply.

14 4. There are regional differences in
15 input costs such as wages, electricity and
16 fuel rates. It is possible that an
17 efficiently operated plant in one region
18 might have a higher per unit manufacturing
19 cost than a less efficient in another region.

20 5. The proportion of butter in bulk
21 and print forms may affect a butter plant's

1 cost.

2 6. When categorizing various in-
3 plant expenses into cost items for this
4 study, different plants may have grouped
5 them differently. Although this should not
6 affect the total cost, care should be used
7 in reading the individual cost items.

8 This concludes my statement.

9 BY MS. DESKINS:

10 Q. Dr. Ling, the last page of your
11 statement consists of a table; is that
12 correct?

13 A. That is right.

14 Q. Did you prepare the table yourself?

15 A. That is right.

16 Q. Is it correct, to the best of your
17 knowledge?

18 A. That is right.

19 MS. DESKINS: Your Honor, I would
20 move for the admission of Exhibit 18.

21 THE JUDGE: Very well, it will be

1 entered.

2 [Whereupon, Exhibit No. 18 was
3 received in evidence.]

4 MS. DESKINS: And I have no further
5 questions for the witness.

6 THE JUDGE: Very well. Questions of
7 this witness? Mr. Yale?

8 EXAMINATION

9 BY MR. YALE:

10 Q. Good morning.

11 A. Good morning.

12 Q. I was afraid somebody wouldn't say
13 anything and you would be down without
14 cross. Couldn't let that happen.

15 Dr. Ling, in this report, you
16 indicate that you have been working with
17 cooperatives; is that correct?

18 A. That is correct.

19 Q. So by that, I would understand that
20 any proprietary plant that produces cheese
21 or butter or any of these other things would

1 not be included in this study?

2 A. That is correct.

3 Q. Can you give us the names of the
4 cooperatives that are involved?

5 A. Yes. That's public information.

6 Q. Okay.

7 A. They are Agri-Mark, Inc.; Associated
8 Milk Producers, Inc.; Dairy Farmers of
9 America.

10 THE JUDGE: Dr. Ling, if you would,
11 slowly. Our hearing reporter is trying to
12 take this down.

13 THE WITNESS: Do I have to repeat it?
14 Foremost Farms USA. Land O'Lakes. Michigan
15 Milk Producers Association. Northwest Dairy
16 Association. Tillamook County Creamery
17 Association. United Dairywomen of Arizona.
18 That's nine cooperatives.

19 BY MR. YALE:

20 Q. Now, can you also tell us what
21 plants were involved, because I think you

1 indicated that there were -- and whether
2 they are all the same plants or if there is
3 some overlap, I don't know, but you
4 indicated here somewhere in the neighborhood
5 of about 40 or 41 plants. Can you identify,
6 you know, for, like, Agri-Mark what plants
7 are involved in that study?

8 THE WITNESS: Do I have permission?
9 Okay.

10 MR. WELLINGTON: Of course, you do.

11 THE WITNESS: Agri-Mark got Cabot
12 Cheese. Chateaugay, Middlebury. Cabot,
13 Vermont, sorry. Chateaugay, New York.
14 Middlebury. Vermont.

15 For butter powder, it's West
16 Springfield, Massachusetts.

17 BY MR. YALE:

18 Q. And what about for AMPI?

19 A. AMPI, I don't have the name. I have
20 the plant location here, but --

21 Q. If you can --

1 A. The powder plant, South Dakota.

2 Freeman, South Dakota. Sorry. And six
3 cheese plants.

4 Q. Okay.

5 A. I believe it is Blair, Wisconsin.

6 Paynesville. Paynesville, Wisconsin.

7 Dawson, Minnesota. Rochester, Minnesota.

8 Sanborn, Iowa.

9 You have to help me.

10 Q. There is one more, I think. Well,
11 you said six.

12 A. Did I say Sanborn, Iowa?

13 Q. Yes.

14 A. All right. Rochester, Minnesota.

15 Dawson, Minnesota. Paynesville, Wisconsin.

16 Blair, Wisconsin. That's six.

17 Q. And the name, again, is what? What
18 was the name of the plant?

19 A. Paynesville, Minnesota.

20 MEMBER OF THE AUDIENCE: Paynesville.

21 THE WITNESS: Yes, Paynesville,

1 Minnesota. The sixth one --

2 BY MR. YALE:

3 Q. I think you have got six now, don't
4 you?

5 A. That was six.

6 Q. What about DFA?

7 A. DFA. For butter, it's Goshen,
8 Indiana; Winnsboro, Texas. For powder, it
9 is Goshen, Indiana. It's Wellsboro,
10 Pennsylvania, and Middlebury, Pennsylvania.
11 Winnsboro, Texas. Fort Morgan, Colorado.
12 For cheese, whey plants, it's New
13 Mexico.

14 MEMBER OF THE AUDIENCE: Lovington.

15 THE WITNESS: Lovington. Lovington,
16 New Mexico. Zumbrota, Minnesota. And
17 Monett, Missouri. BY MR. YALE:

18 Q. Okay. And then is that all? Did
19 they have any butter plants for Agri-Mark
20 that we didn't mention?

21 A. Yes, Agri-Mark is West Springfield,

1 Massachusetts.

2 Q. Okay. And AMPI, were any of these
3 powder plants also butter plants?

4 A. No.

5 Q. And DFA, any of these powder plants
6 also butter plants?

7 A. It is Goshen, Indiana, and
8 Winnsboro, Texas, have butter plant.

9 Q. And we'll come back to those
10 separately.

11 A. Foremost, what plants were those
12 included in?

13 A. Lancaster, Wisconsin.

14 Q. That's it?

15 A. That's it.

16 Q. And is that a cheese or butter
17 powder plant?

18 A. That's a cheese plant, yes.

19 Q. Does it have a butter powder
20 operation in this survey?

21 A. No.

1 Q. And then what about Land O'Lakes?

2 A. Land O'Lakes, one butter plant,
3 Carlisle, Pennsylvania, which is also part
4 of operation.

5 Q. And that's all that's from Land
6 O'Lakes?

7 A. Cheese plant from Wisconsin is Kiel,
8 Wisconsin.

9 Q. Any other -- and that's all of it
10 for Land O'Lakes, those two plants?

11 A. That is correct.

12 Q. Okay. Three plants? Two plants?

13 A. Two.

14 Q. MMPA?

15 A. Michigan Milk Producers, that's two
16 butter and powder plants. One is in
17 Constantine, Michigan. The other one is
18 Ovid, Michigan.

19 Q. That's O-V-I-D?

20 A. O-V-I-D.

21 Q. And Northwest Dairy Association?

1 A. That's -- Northwest Dairy
2 Association is one butter plant in Issaquah,
3 Washington. Four powder plants in --

4 Q. And they are?

5 A. They are Lynden, Washington.

6 Q. Okay.

7 A. Chehalis, Washington. Caldwell,
8 Idaho, and Jerome, Idaho. And one cheese
9 plant, Sunnyside, Washington.

10 Q. Sunnyside?

11 A. Yes.

12 Q. And Tillamook Creamery?

13 A. Tillamook Creamery has two cheese
14 plants. One is in Tillamook, and the other
15 one is in Boardman, Oregon.

16 Q. And the Tillamook is also in Oregon,
17 right?

18 A. That is correct.

19 Q. And they don't have any powder
20 plants or anything. Did they have a powder
21 plant?

1 A. Not that I know.

2 Q. Not in your study. You just had the
3 two cheese plants?

4 A. Yes.

5 Q. All right. UDA?

6 A. UDA is one butter powder plant in
7 Tempe, Arizona.

8 Q. Okay. And that's all that they had?

9 A. That is correct.

10 Q. Now, in terms of the whey
11 operations, who had the whey operations?

12 A. You mean in the -- in my report?

13 Q. Yes, in your report. Who
14 contributed to the whey data?

15 A. You are talking about condensing or
16 drying?

17 Q. Let's talk about the condensed whey,
18 and then we'll talk about the dried whey.
19 Can you explain the difference between
20 condensed and dried whey? Do you know the
21 difference?

1 A. Well, before you dry the whey, you
2 have to condense it first.

3 Q. It's just a little less water, and
4 the dry is a whole lot less water. Is that
5 --

6 A. That is correct.

7 Q. Okay. So the condensed whey, what
8 plants were -- participated in that?

9 A. I don't have the data right in front
10 of me, so -- but my recollection is Cabot,
11 Chateauguay, Keil, Wisconsin. Paynesville.
12 And Sanborn. How many is that?

13 Q. I have got one, two, three, four,
14 five.

15 A. I believe Zumbrota, and I think
16 Monett, or Lovington.

17 Q. Lovington. L-O-V-I-N-G-T-O-N? Is
18 that what you mean?

19 A. Uh-huh.

20 Q. Okay.

21 A. And this plant, I don't recall but

1 might have the condensed and drying
2 separate.

3 Q. So these ones that you said
4 condensed also have dry as well?

5 A. Some plants, just condense and --
6 condense the whey and ship it to other plant
7 for drying. And the dry plant usually have
8 to condense and also dry.

9 Q. And which ones are dry? What plants
10 have dry?

11 A. Kiel plant, Kiel, Wisconsin.
12 Sunnyside. Tillamook. Blair. And Dawson.
13 That's six?

14 Q. I have got five.

15 A. Five.

16 MEMBER OF THE AUDIENCE: Your Honor,
17 Jim Falls, Wisconsin.

18 THE JUDGE: Thank you.

19 THE WITNESS: Oh, Jim Falls,
20 Wisconsin, yes.

21 BY MR. YALE:

1 Q. Very good. So I think we have
2 covered all the plants, right? And I'm
3 impressed, by the way, that you can remember
4 this. That's a tremendous help. Now --

5 A. By the way, that Jim Falls,
6 Wisconsin, plant should also be counted as
7 an AMPI cheese plant.

8 Q. Okay.

9 THE JUDGE: Yes, sir.

10 MEMBER OF THE AUDIENCE: Your Honor,
11 to fill in the condensed whey information,
12 Lancaster, Wisconsin, reported condensed
13 whey.

14 THE WITNESS: That is correct.
15 Lancaster, Wisconsin. Sorry.

16 BY MR. YALE:

17 Q. So, hopefully, some of those
18 individuals from some of these companies
19 will be up and be able to tie that down
20 further.

21 Now, do you know if -- well, first of

1 all, these products, was there any
2 limitation on the type of cheese that could
3 be produced at these plants, or was it all
4 cheeses?

5 A. The project main product was Cheddar
6 cheese, and same thing might produce other
7 cheeses.

8 Q. But the plants were required to
9 isolate the cost for the Cheddar or they
10 reported the cost for all cheeses produced
11 at those plants?

12 A. I asked them if they can do it, to
13 the extent possible, Cheddar cheese. But
14 cost allocations can be a very different
15 task. So if they report some amount of
16 other cheese, they can include them in the
17 cheese produced.

18 Q. So that I understand, if they
19 produced, for example, Monterey Jack cheese
20 in addition to the Cheddar, then if they
21 reported that number and didn't break it out

1 at the plant, you didn't try to break it
2 out?

3 A. No. I had no basis to do it.

4 Q. When they gave you volumes of cheese
5 produced at the plant, did they give you the
6 volumes of cheeses by types or just total
7 volumes of cheese?

8 A. It is usually by type.

9 Q. Did they provide you any information
10 regarding the yields, that is, the pounds of
11 cheese produced per a hundred pounds of milk
12 received?

13 A. They did not. But I tried to
14 collect it based on the pounds of cheese
15 they made and the milk that goes into the --
16 or milk or creamery that goes into the
17 cheese production.

18 Q. But you didn't report that in this
19 study?

20 A. It's -- it is on the table.

21 Q. On the table? Okay.

1 And this is all cheeses; is that
2 right? And then you broke out for the
3 40-pound blocks of Cheddar?

4 A. That's correct.

5 Q. Now, what happened if -- if you
6 didn't know, if the plant did not provide
7 the breakdown between the types of cheese,
8 whether it was block or barrel or Cheddar or
9 something else, did you just not include
10 that in that number? How did you handle
11 that?

12 A. I asked for type of cheese they
13 make. So if they report 40-pound blocks,
14 then it's 40-pound block. If I cannot make
15 -- if the plant has several type of cheese
16 and 40-pound block is not predominant
17 cheese, I don't include them in the 40-pound
18 block.

19 Q. But if it was predominant, you did?

20 A. Pardon me.

21 Q. If it was predominant, you did?

1 A. That is correct.

2 Q. So that number might include 640s or
3 500-pound barrels, right?

4 A. You mean for all cheeses?

5 Q. For the 40-pound block cheese total.

6 A. No.

7 Q. It's pure 40-pound block?

8 A. Yes, pure 40-pound blocks plus some
9 other special cheeses.

10 Q. Now, again, talking about the
11 cheeses that we have, I noticed on Note 1,
12 on page 3, that the cost analysis does not
13 consider differences in product quality.

14 A. That is correct.

15 Q. All right. Now, do you know -- let
16 me kind of try to set up a background to see
17 if you understand this. Do you understand
18 that NASS, the National Agricultural
19 Statistical Service, reports weekly the
20 sales of 40-pound block and 500 pound
21 Cheddar cheese. Are you aware of that?

1 A. That is correct.

2 Q. All right. But it is a very --
3 would you agree that some of these plants
4 produce a Cheddar cheese that is of a
5 different quality than that that would be
6 reported on NASS?

7 A. I don't have any idea.

8 Q. Do you know if any of these plants
9 report the sales of their cheese to NASS?

10 A. No, I don't.

11 Q. Okay. Are you a purchaser, a user
12 of cheese yourself?

13 A. That is correct.

14 Q. And you would recognize, some of
15 these have some pretty high -- not
16 disparaging the others, but a couple of
17 these have some very high names, do they
18 not, for the quality and their type of
19 cheese?

20 A. That is correct.

21 Q. Such as Tillamook or Cabot?

1 A. That is correct. And I pay for
2 them.

3 Q. Pardon?

4 A. I bought them, and I pay for them.

5 Q. Right.

6 A. So no freebie.

7 Q. That's because extra quality has a
8 price, right?

9 A. That is correct.

10 Q. But your study doesn't account for
11 the fact that they might be producing a
12 different quality cheese than another plant?

13 A. That is correct.

14 Q. Do you know what the volume, does
15 your report give us the volume of cheese
16 that these plants represent?

17 A. If you look at the table --

18 Q. Yes.

19 A. -- toward the -- that item there
20 called pounds of product per plant --

21 Q. Right.

1 A. -- you take all cheeses --

2 Q. Okay.

3 A. -- 62 million pounds, you time that
4 by 17 plants.

5 Q. Okay.

6 A. That will get you a little bit more
7 than the one million pound of cheese.

8 Q. Okay.

9 A. And for other products, you can do
10 the same thing.

11 Q. So then, for the 40-pound blocks, it
12 would be six times the 69 million?

13 A. That is correct.

14 Q. Did your -- I noticed that your
15 statement says it is from receiving deck to
16 shipping deck. So you don't have any
17 knowledge or information regarding what the
18 plants actually paid for milk?

19 A. No.

20 Q. On page 3, again, of your statement,
21 item No. 3, you indicated a -- there is a

1 comment there that talks about a plant
2 that's in the production mode has a
3 different cost than those that are used for
4 balancing, is that correct?

5 A. That is correct.

6 Q. Do you know which of any of these
7 plants are balancing plants that you have
8 named?

9 A. I would say most of them are
10 balancing plants, but the powder, are
11 balancing plants.

12 Q. Now, in doing the cost analysis, did
13 you request or do you know if they included
14 any offsetting income to any of those costs?

15 A. No.

16 Q. They --

17 A. It is -- the project is strictly
18 cost incurred inside the plant.

19 Q. So if a plant, for example, a
20 balancing plant, had a contract with some
21 other entity in which they were paid to have

1 that plant available for balancing to offset
2 some of their labor costs to keep the labor
3 during the low production months, that would
4 not reflect in here?

5 A. No.

6 Q. Were any -- this is -- you say it's
7 totally voluntary. You did not do any audit
8 function to determine the accuracy of this
9 data yourself?

10 A. That is correct.

11 MR. YALE: I think at this point,
12 Your Honor, I don't have any other
13 questions.

14 THE JUDGE: Very well. Other
15 examination?

16 MR. WELLINGTON: Good morning. Bob
17 Wellington for Agri-Mark Dairy Cooperative.

18 THE JUDGE: Very well, Mr.
19 Wellington.

20 EXAMINATION

21 BY MR. WELLINGTON:

1 Q. Charlie, first of all, thank you for
2 conducting this study. It's always been very
3 helpful to the co-ops around the country.

4 This time around with this study,
5 were the number of plants that were surveyed
6 typical to the number in the past or was it
7 greater or less than?

8 A. It is greater than in the past.

9 Q. A significantly greater number, to
10 your knowledge?

11 A. Yes.

12 Q. Thank you. When you were asking for
13 information on the condensing operations, in
14 particular, were you asking for any
15 information about the particular type of
16 condensing operation? By that, I mean
17 removing just the water, keeping all the
18 milk solids, or removing the water and
19 separating out the milk solids like protein
20 and lactose. Did you break out those types
21 of plants?

1 A. I have a page specifically for
2 condensing costs. If they indicated that
3 it's for -- if they indicate the cost
4 involved filtration, I did not include the
5 plant.

6 Q. Thank you. Are the costs of
7 handling cheese beyond the point of when
8 cheese is manufactured and put in its
9 whatever original form, whether it be a
10 40-pound block, paper package or a barrel or
11 whatever, are the costs of handling that
12 cheese after that point, is that included in
13 your --

14 A. No.

15 Q. No? Are the costs of aging the
16 cheese included?

17 A. No.

18 Q. No? Are the cost of any retail
19 packaging, packaging or anything else that's
20 involved?

21 A. No.

1 Q. Or marketing any products?

2 A. No.

3 Q. So you had said that you agreed with
4 Mr. Yale that the extra quality comes with a
5 higher price. But would you agree that the
6 extra quality also comes with a higher cost
7 than reflected in your study?

8 A. That is correct.

9 Q. Thank you.

10 THE JUDGE: Mr. Schad. Would you
11 identify yourself and spell your name for the
12 hearing reporter, please.

13 MR. SCHAD: Yes, my name is Dennis
14 Schad. S-C-H-A-D. May I have -- I would
15 like to put two exhibits in. May I have the
16 exhibit numbers?

17 THE JUDGE: They will be 19 and 20.
18 Mr. Schad, are you here today for Land
19 O'Lakes?

20 MR. SCHAD: I am.

21 [Whereupon, Exhibits 19 and

1 20 were marked for identification by the
2 judge.]

3 MR. SCHAD: Charlie, Dr. Ling, thank
4 you for coming, and thank you for what
5 you've done for --

6 THE JUDGE: Just for clarification,
7 Exhibit 19 is 1998 Dairy Product Plant Costs
8 USDA/Cooperative Programs Technical
9 Assistance Project. Exhibit 20 has that
10 label with paren, California plants not
11 included.

12 EXAMINATION

13 BY MR. SCHAD:

14 Q. I would ask you to turn to Exhibit
15 19. And would you identify Exhibit 19.
16 Have you seen this before?

17 A. That's the result of 1998 dairy
18 product plant cost study I did, and I
19 believe was entered into the 2000 hearing
20 record.

21 Q. You are correct. It was entered as

1 an exhibit within the 2000 Class III-Class
2 IV hearing. Would you -- and I call your
3 attention only to the columns for butter and
4 powder. Would you read for me the simple --
5 okay, strike that.

6 Would you also go to Exhibit 20.
7 Would you identify that exhibit.

8 A. Exhibit 20, it's the same study
9 without California plants included in the
10 calculation. Two butter powder plants were
11 excluded.

12 Q. And 2005, did I come to you and
13 point out to you that there were two
14 California plants that were included in the
15 1998-1999 survey that was put into evidence
16 in the last hearing?

17 A. That is correct.

18 Q. Did you subsequently run the same
19 numbers but exclude the California plants in
20 your calculations?

21 A. At your request, I did that after I

1 got permission from the cooperative that
2 owned the two butter powder plants.

3 Q. And Exhibit 20 reflects that -- the
4 1998-1999 cost without the two California
5 plants?

6 A. That is correct.

7 Q. So if we go across, I would like to
8 point a the couple places where there are
9 differences between the two exhibits. Is it
10 true that the simple average butter price,
11 when you have seven plants, was 13.603, and
12 it was -- when you only had five, it was
13 14.938?

14 A. That's for the simple averages,
15 correct.

16 Q. Right. And also, the butter -- the
17 butter cost also increased when you took the
18 two California plants out?

19 A. That is correct.

20 Q. If you looked at the pounds per
21 product per plant, which is a measure of

1 plant size, loosely, I would assume?

2 A. Correct.

3 Q. Would you agree with me that the
4 original exhibit that was given to USDA had
5 23.8 million pounds butter plant, and it
6 decreased to 19.6 million pounds?

7 A. That is correct.

8 Q. And also, on the powder side, you
9 also saw a 38.8 million pound average plant
10 -- average production size to 29.1?

11 A. That is correct.

12 Q. And if we go down to the weighted
13 average cost, the weighted average cost for
14 butter originally submitted was 10.6. It is
15 now 11.2?

16 A. That is correct.

17 Q. That's -- if you did the math, that
18 would be a 6 percent increase in cost?

19 A. All right. If you say so, yes.

20 Q. Okay. And also, the powder cost,
21 originally submitted at 12.7 cents, it is

1 now 14.5 cents, rounded. That would be also,
2 if you did the math, a 14 percent increase
3 in cost?

4 A. If you say so, yes.

5 Q. Would you want to comment on the
6 significance of the differences a person --
7 given your role as a -- collecting these
8 costs from cooperatives, would you say that
9 this is a significant result?

10 A. It depends on how you define
11 significant. That's a very -- my job is to
12 present effects, and I don't pass judgment
13 on the numbers I present.

14 Q. Thank you very much.

15 A. You are welcome.

16 THE JUDGE: Other questions of this
17 witness? Mr. Beshore.

18 EXAMINATION

19 BY MR. BESHORE:

20 Q. Marvin Beshore. Dr. Ling, just a
21 question or two. Was the methodology that

1 you used in your 1998 study reflected in
2 Exhibits 19 and 20 the same methodology that
3 you used for your 2004 study?

4 A. That is correct.

5 Q. And was the information that you
6 requested of the cooperatives the same in
7 2004 as in 1998?

8 A. The co-ops request -- made the
9 request to me were the same as in 1998. So
10 everything stayed the same as in 1998.

11 Q. Okay. And as we can observe, the
12 cost categories were the same from year to
13 year as well?

14 A. That is correct.

15 Q. Okay. Thank you.

16 THE JUDGE: Mr. Rosenbaum. Just
17 identify yourself again, please.

18 MR. ROSENBAUM: Yes, sir. Steve
19 Rosenbaum for the National Cheese Institute.

20 EXAMINATION

21 BY MR. ROSENBAUM:

1 Q. Dr. Ling, I just want to -- maybe --
2 I would like to get a little more detail
3 about some of the costs that are excluded
4 based upon your survey methodology, what you
5 list on the bottom of page 1 of your
6 statement. So maybe if you could just take a
7 look at that, on the first page of Exhibit
8 18.

9 A. Page 1?

10 Q. Yes, the first page at the bottom.
11 And you state that you have excluded milk
12 procurement costs?

13 A. That is correct.

14 Q. And you had done that with respect
15 to the survey as to what you testified back
16 in the 2000 hearings as well, correct?

17 A. That is correct.

18 Q. And so that, for example, if the
19 cooperatives that participated in this survey
20 have field men who go into the field and
21 help participate in the procurement of milk,

1 those costs are excluded in the calculations
2 that are set forth on the table to your
3 exhibit, correct?

4 A. That is correct.

5 Q. And you would agree with me that
6 that's a necessary cost of an operation,
7 correct?

8 A. That is correct.

9 Q. It is simply beyond the scope of
10 your survey?

11 A. That is correct.

12 Q. And then another issue you identify
13 as being excluded from your survey is
14 administrative costs, correct?

15 A. That is correct.

16 Q. And you helpfully provide, at the
17 top of page 2, some further detail that
18 administrative costs in this context include
19 plant office, plant manager and corporate
20 overhead, correct?

21 A. That is correct.

1 Q. And so, once again, you would agree
2 that these are costs that are necessary
3 costs of operations, correct?

4 A. That is correct.

5 Q. But they are excluded from your
6 survey and, therefore, not included in the
7 costs that are set forth on the last page of
8 your exhibit?

9 A. That is correct.

10 Q. Once again, that's the same thing
11 you did back in 1998?

12 A. That is correct.

13 Q. Another issue that you note as being
14 excluded from your survey is what you term
15 interest, correct?

16 A. Yes.

17 Q. Now, obviously, it takes capital to
18 purchase a plant and the equipment in a
19 plant, correct?

20 A. That is correct.

21 Q. Which might hypothetically be raised

1 by borrowing, correct?

2 A. That is correct.

3 Q. And in that context -- and that's
4 the context in which you are using the
5 phrase interest here. Is that right?

6 A. That is correct.

7 Q. Would you agree you could also
8 describe that as capital costs?

9 A. That is correct.

10 Q. And once again, that is excluded
11 from your survey and, therefore, excluded
12 from your numbers that appear on the last
13 page of the exhibit, correct?

14 A. That is correct.

15 Q. And then one issue that you didn't
16 mention explicitly but, I mean, I think it
17 is probably implicit, is marketing costs
18 with respect to the finished product,
19 correct?

20 A. That is correct.

21 Q. That is an item that is not covered

1 by your survey, correct?

2 A. That is correct.

3 Q. But nonetheless, a necessary cost of
4 the plant operation, presumably?

5 A. That is correct.

6 MR. BESHORE: That's all I have.
7 Thank you.

8 THE JUDGE: Other questions of Dr.
9 Ling? Mr. Vetne. Just identify yourself
10 again.

11 EXAMINATION

12 BY MR. VETNE:

13 Q. Good morning, Dr. Ling. John Vetne.
14 I'm an attorney for Agri-Mark.

15 Could you look at page 2 of your
16 statement, please. The middle of the page
17 you say, "For reporting cost data on cheese
18 plants, these two instructions replace the
19 previous Items 2 and 3."

20 My question on that is, did the
21 previous Items 2 and 3 apply to prior cost

1 studies?

2 A. That is correct.

3 Q. And the replacement applied to the
4 '04 study, the replacement instructions?

5 A. Yes, that is correct.

6 Q. So there was a little bit different
7 instruction in '04?

8 A. No, the instruction is exactly the
9 same, maybe some area change.

10 Q. Okay. If a cheese plant in your
11 study received some condensed or
12 concentrated milk, do you know whether your
13 study would include the costs of condensing
14 or concentrating that milk off-site as part
15 of the cheese make cost?

16 A. No, I do not. I don't have the
17 number.

18 Q. Was there an instruction that would
19 allocate a cost off-site, maybe a third
20 party, to the concentration or condensing of
21 milk before it hits the cheese plant?

1 A. Oh, I told them if they received
2 condensed for putting in the milk, they
3 should do it. But whether they do it or
4 not, I have no way of knowing.

5 Q. Okay. Was your instruction that
6 they do it based on their own condensing
7 costs or somebody else's?

8 A. It is up to them.

9 Q. Your instructions also do not
10 include -- intentionally do not include any
11 shipping or transportation costs, is that
12 correct?

13 A. That is correct.

14 Q. There are a number of cheese plants
15 that do not process their own whey into dry
16 weight products; is that correct?

17 A. That is correct.

18 Q. And the cost information that you
19 elicited does not include the costs for
20 those cheese plants of loading, transporting
21 and unloading either whole or condensed whey

1 from Cheese Plant A to whey processing Plant
2 B?

3 A. Well, I think in my instruction I
4 said, if you receive whey or receive product
5 before the processing, you should include
6 the receiving cost in there. That's on the
7 --

8 Q. That's on the receiving end?

9 A. Yes.

10 Q. But on the cheese side, on the
11 cheese plant that does not make a whey -- dry
12 whey product, the cost of -- the cost of
13 loading the liquid whey or condensed whey and
14 transporting the liquid whey or condensed
15 whey for further processing into dry whey,
16 those costs are not included?

17 A. That is correct.

18 Q. And in the 2004 data that you
19 reported today in Exhibit 13 -- is that what
20 it is? Exhibit 18. Those data do not at
21 this time include any California plants; is

1 that correct?

2 A. That is correct.

3 Q. In response to a question by Mr.
4 Yale about balancing, you responded most of
5 the plants balance?

6 A. The powder plants.

7 Q. Pardon?

8 A. Butter powder plants.

9 Q. The butter powder plants are the
10 primary balancers; is that correct?

11 A. That's most of them.

12 Q. Okay.

13 MR. VETNE: That's all I have.

14 THE JUDGE: Other questions of Dr.
15 Ling?

16 Very well, Dr. Ling.

17 Excuse me. Mr. Miltner.

18 MR. MILTNER: Ryan Miltner on behalf
19 of Select Milk Producers, Continental Dairy
20 Products and Dairy Producers of New Mexico.

21 EXAMINATION

1 BY MR. MILTNER:

2 Q. Dr. Ling, this survey that's been
3 done now for 20 some years did not originate
4 as a survey to set make allowances, is that
5 correct?

6 A. That is correct.

7 Q. Until 1998, it was never used to set
8 make allowances; is that correct?

9 A. Say that again.

10 Q. Until 1998 or 1999, the data was
11 never relied upon to set make allowances?

12 A. That is correct.

13 Q. And you answered in response to a
14 question from another participant that
15 participation in the survey in the most
16 recent year was much higher than in the
17 past; is that correct?

18 A. For 2004.

19 Q. Yes.

20 A. That is correct.

21 Q. Was the participation significantly

1 higher than in the past, the number of
2 plants participating?

3 A. Again, it is depending on what --
4 how you define significant.

5 Q. Okay. It is probably in the data,
6 but can you give us some numbers as to
7 historically how many plants participated
8 and how many participated in 2004?

9 A. I noticed that 2004 numbers are
10 higher, but for previous year I have to look
11 at the numbers to tell you.

12 Q. But it was enough of a change that
13 you noticed it?

14 A. I have to do more work, we have more
15 plants, so I notice it.

16 Q. Thank you. And this survey is
17 voluntary, right?

18 A. That is correct.

19 Q. The cooperatives are not obligated
20 to participate in the survey?

21 A. That is correct.

1 Q. The nine cooperatives who did
2 participate in the survey in 2004, do you
3 know if those cooperatives submitted data
4 for all of their Class III and Class IV
5 plants?

6 A. To my knowledge, yes, but I'm -- I
7 am not one hundred percent sure.

8 Q. But you do believe that those
9 cooperatives didn't pick and choose among
10 their plants, they submitted data on all of
11 them?

12 A. That is correct.

13 Q. The cooperatives that participated,
14 they consented to you releasing the
15 information you have included in Exhibit 18?

16 A. That is correct.

17 Q. Did they consent to you releasing
18 the ranges of data in each of the categories
19 on Exhibit 18?

20 A. I asked them to -- they give
21 permission to me to testify and explain my

1 work.

2 Q. Okay. If we asked you to provide
3 the highs and lows, the ranges for each of
4 the categories and the summaries, would that
5 be information you would be able to provide
6 for us before the end of the hearing?

7 A. You want the range?

8 Q. Yes.

9 A. For the specific cost items or just
10 the average?

11 Q. I would like it for each number on
12 the chart. Not right now, obviously, but if
13 that data is available to you and you can
14 compile it for us before we all scatter
15 across the country, that would be
16 appreciated, without disclosing, you know,
17 the individual plants, of course.

18 A. The highs and lows range?

19 Q. Yes.

20 A. I would think so, if so requested.

21 Q. Yes, I would like to make that

1 request. And if you can provide that for
2 us, we appreciate it.

3 A. If there is no objection from the
4 cooperatives participating.

5 MS. DESKINS: As long as you are not
6 disclosing any information that you need to
7 keep confidential due to agreements with the
8 co-ops.

9 THE JUDGE: Sounds, Mr. Miltner, like
10 it is a qualified yes.

11 MR. MILTNER: Yes. Thank you.

12 BY MR. MILTNER:

13 Q. I just want to touch on one question
14 that Mr. Yale asked. He confirmed with you
15 that these numbers are not audited?

16 A. That is correct.

17 Q. What assurances do you have that
18 the data provided to you is accurate?

19 A. It is -- I was requested to do
20 it for purpose of comparing their operations
21 for their management purposes. On that

1 basis, if they have to spend time and cost
2 in correcting the data and submit it to me,
3 I -- that's my assurance that they want the
4 numbers accurate and correct.

5 Q. So you rely on the good faith of
6 those participating in the survey?

7 A. That is correct.

8 Q. Have you ever found yourself in a
9 situation where a number didn't add up or
10 you had a question about the data that was
11 submitted to you?

12 A. If I do, I will go back to them and
13 figure out why the number is incorrect.
14 But, no, no, I think what you are getting at
15 is probably funny numbers in there. The
16 answer is no.

17 Q. You usually -- if there is a
18 question in your mind, that's usually
19 resolved to your satisfaction?

20 A. That is correct.

21 Q. I don't want to bring up a whole lot

1 of what happened several years ago, but in
2 your testimony at the last hearing on this
3 issue, there was a question similar to the
4 one I just asked, about problems with
5 numbers that you thought may have been out of
6 line. And I would be paraphrasing, but did
7 you say something to the effect of when you
8 follow up and the response you get from the
9 cooperative is cool, you just run with the
10 numbers you have?

11 A. That would depend on my judgment at
12 the specific time, whether it is -- if it is
13 justified or not.

14 If it is not, I kick them out of the
15 report.

16 As I stated in my -- as I stated in
17 my Exhibit 18, this year I didn't include
18 one butter plant, I took powder plant out of
19 the report.

20 Q. Okay. Do you ever find yourself in
21 a situation where you are trying to follow

1 up and verify numbers and you don't -- you
2 are unable to satisfy yourself as to the
3 accuracy or validity of the numbers?

4 A. If that happens, I don't include
5 them in my report.

6 Q. Okay. The data that you collect, is
7 there any information provided by the
8 participants on the profit or loss of their
9 plant?

10 A. I don't understand your question.
11 Say it again.

12 Q. Sure. A plant provides you
13 information on its costs. Do they also
14 provide you with any information as to the
15 profitability of that plant for making that
16 specific product?

17 A. No.

18 MR. MILTNER: I don't have any other
19 questions. Thank you, Dr. Ling.

20 THE JUDGE: Mr. Vetne.

21 EXAMINATION

1 BY MR. VETNE:

2 Q. John Vetne for Agri-Mark.

3 To add some clarity to your answer to
4 the last question, the -- in the case of
5 Cheddar in 40-pound blocks, for example, the
6 product that you are studying for cost of
7 making is 40-pound blocks off the cheese
8 vat, ready to do something else with,
9 correct?

10 A. That is correct.

11 Q. If the product a plant is making is
12 cheese for aging and the plant makes -- you
13 know, ages the cheese, that's not the
14 product that you studied. You studied fresh
15 Cheddar off the vat?

16 A. That is correct.

17 THE JUDGE: Other questions of Dr.
18 Ling? Mr. Yale.

19 EXAMINATION

20 BY MR. YALE:

21 Q. Dr. Ling, do you recall what plants

1 reported in 2004 that did not report in
2 1998?

3 A. I have to go through the list to --

4 Q. Could that be provided later, I
5 mean, in just a list? I mean, I don't know
6 that it -- I would just like to have the
7 information in the record. I don't have any
8 follow-ups specifically.

9 A. I believe I can do it.

10 Q. And the other -- when the letter
11 went out -- do you send the letter out to
12 all cooperative plants requesting them to
13 participate?

14 A. No, they send the request letters to
15 me.

16 Q. So you don't know if there was any
17 kind of an effort to increase the number of
18 participates in 2004 by any organization or
19 official or otherwise to get greater
20 participation?

21 A. That is correct.

1 Q. Now, also, if you would look at
2 Exhibit 20 and compare that to Exhibit, what
3 was it, 18, I believe, is the cheese in
4 Exhibit 20, the column, is that reflecting
5 the same cheese as all cheeses in Exhibit 18
6 or is it reflecting any different types of
7 cheeses?

8 A. It is all cheeses.

9 Q. Okay. And there was not only a
10 difference in cost but there was also a
11 difference in the yields, was there not,
12 that you had implied?

13 A. That is correct.

14 MR. YALE: I have no other questions.
15 Thank you.

16 THE JUDGE: Very well. Mr.
17 Wellington.

18 EXAMINATION

19 BY MR. WELLINGTON:

20 Q. Bob Wellington at Agri-Mark.

21 Charlie, I understand now you are

1 going to be providing high and low ranges?

2 A. That is correct.

3 Q. When you provide those high and low
4 ranges, is it going to be likely that there
5 is going to be a zero as a low range for
6 many of the categories?

7 A. Many of them will be zero. As I
8 stated in my statement, you know, the -- it
9 is page -- probably the third page.

10 Q. Okay.

11 A. The last point I made, when they --
12 when plants categorize the expenses into cost
13 items, they -- different plans might do it
14 differently. And sometimes, if they have no
15 way of breaking out, they would put a zero
16 there and assign it to something else. And
17 so the low will be a lot of zeros, yes.

18 Q. But wouldn't that also affect the
19 high in other categories where it went --

20 A. That's right.

21 Q. -- where that cost was put into?

1 A. That is correct.

2 Q. So it isn't necessarily a fact that
3 if a number shows up as zero, for example,
4 you look at cleaning supplies, it doesn't
5 mean a plant doesn't use any cleaning
6 supplies?

7 A. That is correct.

8 Q. But if you also look at a number and
9 it's very high for something like
10 miscellaneous, it could be because they put
11 that plant -- put those cleaning costs into
12 that category?

13 A. That is correct.

14 Q. Thank you.

15 THE JUDGE: Other questions?

16 Very well. Dr. Ling, it looks like
17 you may step down.

18 MS. DESKINS: Thank you for
19 testifying, Dr. Ling.

20 THE WITNESS: You are welcome.

21 THE JUDGE: Ms. Deskins, it is about

1 20 till. Do you want to start another
2 witness or do you want to take a break at
3 this time?

4 MS. DESKINS: Judge, I think we could
5 start. I have two people that want to
6 testify together. They could at least read
7 their statements. It's fairly short. Maybe
8 we could take them.

9 THE JUDGE: Very well. This is a
10 joint testimony?

11 MS. DESKINS: Yes. And the witnesses
12 are Kelly Krug and Venetta Reed.

13 THE JUDGE: This will be Exhibit 21,
14 Ms. Deskins.

15 [Whereupon, Exhibit No. 21
16 was marked for identification by the judge.]

17
18 [Whereupon, the witnesses
19 were duly sworn by the judge.]

20 THE JUDGE: Please be seated, and
21 if you would, Mr. Krug, and then Ms. Reed,

1 give your name to the hearing reporter and
2 spell your last name.

3 WITNESS KRUG: My name is Kelly
4 Krug. K-R-U-G, K-E-L-L-Y.

5 WITNESS REED: My name is Venetta
6 Reed, R-E-E-D. First name, V-E-N-E-T-T-A.

7 EXAMINATION

8 BY MS. DESKINS:

9 Q. Mr. Krug, it is my understanding
10 that you have a prepared statement?

11 A. Yes, I do.

12 Q. Would you like to read that?

13 STATEMENT FOR THE RECORD BY KELLY KRUG

14 A. Kelly Krug. I'm Director of
15 Marketing Services for the California
16 Department of Food and Agriculture. Thank
17 you for the invitation to give a statement
18 regarding the California Department of Food
19 and Agriculture's use of manufacturing cost
20 allowances. With me is Venetta Reed,
21 Supervising Auditor from our agency who is

1 prepared to give a more detailed summary and
2 overview of the process of acquiring and
3 posting manufacturing cost data for
4 California manufacturing plants.

5 One of the functions within our
6 division is to collect cost data from
7 California manufactured milk processing
8 plants on a voluntary basis. The level of
9 cooperation from plants is very high and the
10 studies cover nearly all the production of
11 the intended products in the analyses we
12 perform. California's end product dairy
13 pricing formula start with the whole sale
14 price for Grade AA butter, nonfat dry milk
15 and Cheddar cheese and subtract a
16 manufacturing cost allowance to determine the
17 value or the price for milk. It is
18 customary for the Department to hold
19 hearings generally in response to industry
20 petitions to consider adjustments to pricing
21 formulas including the values of the

1 manufactured cost allowances.

2 A key factor for Department
3 determinations that may adjust the
4 manufacturer's cost allowances for the Class
5 IVa and 4b pricing formulas is the
6 Department's work of conducting annual
7 manufacturing cost studies to ascertain
8 processing cost for butter, nonfat dry milk
9 and Cheddar cheese. The Department has a
10 longstanding history relying on processing
11 cost study data combined with relevant
12 economic supply and demand factors to
13 update the manufacturing cost allowances for
14 butter, nonfat dry milk and Cheddar cheese.
15 Additionally, in 2003, for the first time the
16 Department also added a make allowance
17 factor for dry whey. At public hearings,
18 interested parties are given an opportunity
19 to provide testimony and evidence regarding
20 manufacturing cost data and any relevant
21 economic factors that should be considered in

1 evaluating appropriate level of the
2 manufacturing cost allowances.

3 Toward the goal of keeping the
4 Department's cost studies as relevant and
5 accurate as possible in 2002, we employed a
6 private accounting firm with experience in
7 the field of cost accounting to review the
8 work of our dairy manufacturing cost unit.
9 Following an extensive examination, the firm
10 determined the methodology the Department
11 has been using is sound and follows
12 customary cost accounting techniques.

13 And at this time, if it's your
14 pleasure, Venetta Reed is prepared to
15 provide a more detailed summary of how we
16 conduct dairy manufactured cost studies.

17 THE JUDGE: Ms. Reed's statement has
18 been marked as No. 22.

19 [Whereupon, Exhibit No. 22 was
20 marked for identification by the judge.]

21

1 STATEMENT FOR THE RECORD BY VENETTA REED

2 WITNESS REED: My name is Venetta
3 Reed. I am Supervising Auditor of the
4 Manufacturing Cost Unit for the Dairy
5 Marketing Branch of the California Department
6 of Food and Agriculture. I have worked in
7 the dairy cost accounting for 20 years.

8 The Department has been responsible
9 for collecting and publishing manufacturing
10 costs on butter, nonfat dry milk powder and
11 cheese for over 35 years. Due to changing
12 trends in the dairy industry the Department
13 started skim whey powder cost collection in
14 the 2003 cost study period.

15 The criteria for product costs are
16 for cheese 40-pound blocks of 500 pound
17 barrels, butter 25kg and 68 pound blocks,
18 nonfat dry milk powder is 25kg bags and
19 50-pound bags, and skim whey powder is 25kg
20 bags. The Department categorizes costs in
21 the following line items: processing labor,

1 processing nonlabor which includes costs
2 such as utilities repairs and maintenance,
3 supplies, depreciation and rent, packaging
4 other ingredients, general and
5 administrative and also return on investment.

6 The published costs are compiled from
7 manufacturing plants on a voluntary basis.

8 These are not mandatory audits. The 2004
9 cost study by period represented 99.9
10 percent of butter production, 98.5 percent of
11 Cheddar and Monterey Jack cheese production,
12 99.17 percent of nonfat dry milk powder
13 production and 79 percent of skim whey
14 powder production in California for the year
15 of 2004. Information is gathered annually
16 from manufacturing plants to cover the prior
17 12-month period. The areas covered in the
18 cost study are:

19 RECEIPTS IN USAGE:

20 The receipt portion is all raw milk
21 and other dairy products into the plant from

1 all sources which is used in the
2 manufacturing process. Receipts of milk
3 products include the total pounds, butter
4 fat pounds and solids nonfat pounds. The
5 usage section is an account of all products
6 processed from the received milk for the
7 period covered.

8 The records used are the monthly
9 Milk Pooling branch 800 report, or the
10 companies work papers used to compile the
11 800 report. For finished product
12 information we use the plant's production
13 records.

14 PAYROLL:

15 Labor is a major factor of
16 processing costs. Therefore, the auditor
17 must ensure that all labor costs are
18 included in the study. This will include
19 the confidential payroll and bonuses of the
20 executive staff. Total gross wages must be
21 picked up for each employee including

1 vacation, holiday, sick, jury duty, et
2 cetera, to reflect the entire process
3 period. Payroll taxes and fringe benefits
4 such as pensions, health and life insurance
5 are computed on the basis of the most
6 current rates available at the time the
7 field work is conducted. The expenses
8 recorded in the company's general ledger for
9 fringe benefits and payroll taxes are
10 adjusted out and replaced by the more
11 current computed amounts. The most current
12 rate and experience factor for Workers'
13 Compensation insurance is used unless the
14 company is self-insured. For a self-insured
15 company, the expense found in the trial
16 balance is allocated based on the number of
17 employees in each payroll category.

18 FUNCTIONAL ANALYSIS:

19 A tour of the plant is made prior to
20 compiling the functional analysis. During
21 the plant tour, various operations are noted,

1 including the different types of machinery,
2 their production capability, number of
3 staff required to run each machine and the
4 number of days and hour in which they
5 operate. To determine and distribute each
6 employee's percentage of time, a list of each
7 employee for the period of the study is
8 forwarded to the plant manager or one of the
9 direct supervisors to distribute the
10 employee's percentage of time spent in each
11 Department.

12 DEPRECIATION:

13 It is the policy of the dairy
14 marketing branch that all cost studies should
15 use the straight line method for computing
16 depreciation expenses. The policy requires
17 the use of acquisition date and the original
18 cost of the asset with no salvage value.
19 However, for the 2005 year studies, a
20 salvage value of 10 percent of the original
21 cost will be retained. The records received

1 are a complete listing of the plant's
2 assets.

3 RETURN ON INVESTMENT:

4 The return on investment allowance
5 represents how much interest income the
6 company could earn if their capital was not
7 tied up in land, buildings and equipment.
8 All long-term interest expense is adjusted
9 out of the company's books. The return on
10 investment allowance replaces long-term
11 interest. However, short-term interest
12 remains on the company's books as an
13 interest expense. A remaining book value
14 figure for each asset is calculated by
15 subtracting accumulated depreciation from the
16 original cost of the asset. The remaining
17 book value is then multiplied by a weighted
18 annual Moody's BAA Bond Index rate to arrive
19 at a return on investment allowance.

20 GENERAL LEDGER:

21 The general ledger section of the

1 cost study includes all of the expenses
2 incurred by the handler during the cost
3 study period. It is composed of an audited
4 trial balance, a schedule of adjustments, an
5 analysis of those accounts determined by the
6 auditor for certain consideration. A report
7 of general ledger accounts and amounts for
8 the study period are forwarded to the
9 auditor usually by the CFO or the senior
10 accountant. Utility invoices are also part
11 of the record collection for the general
12 ledger.

13 RAW PRODUCT:

14 The raw product component is
15 included in the cost study but it is not a
16 part of the total processing costs except
17 for nondairy ingredients. The milk portion
18 of raw product cost is computed using the
19 component pricing for butter fat and solids
20 not fat on an average for the year published
21 by the dairy marketing branch.

1 PACKAGING:

2 Packaging expenses are set up in the
3 cost study as a separate component cost for
4 each product broken down by individual
5 sizes. Thus, packaging supplies expense is
6 eliminated from the general ledger.

7 Packaging costs are determined based on the
8 latest available invoice price, plus
9 freight, less discounts, if any. Total cost
10 include all nonreusable items used in the
11 packaging of the product such as boxes, bags,
12 cartons, liner, tape, glue and stretch wrap.
13 Now, these are compiled summary pages but
14 also a part of cost study.

15 PROCESSING LABOR:

16 The processing labor section
17 allocates to finished products the total
18 wages, payroll taxes and fringe benefits of
19 all plant employees. These labor costs are
20 brought forward from the payroll and
21 functional analysis section to the labor

1 distribution schedule.

2 PROCESSING NONLABOR:

3 Processing nonlabor costs include all
4 direct and indirect plant expenses except
5 those pertaining to payroll cost. The
6 analyses of these expenses are contained in
7 the general ledger, but the final expense
8 allocation to the various products is
9 usually completed in the processing nonlabor
10 section.

11 GENERAL AND ADMINISTRATIVE COSTS:

12 General and administrative costs
13 include all the expenses incurred at the
14 direction, control and management of company.
15 Included in those costs. I'm sorry --
16 included in those expenses are all payroll
17 costs associated with the administration of
18 the business such as office clerical wages
19 and executive salaries. Examples of other
20 G&A expenses are office supplies, short-term
21 interest, dues and subscriptions, accounting

1 fees and headquarter charges.

2 The final schedule in the cost study
3 called a summary of unit cost. It combines
4 all the various costs from other sections of
5 the cost study into final cost figures for
6 each dairy product.

7 MS. DESKINS: Judge Davenport, I have
8 one more exhibit that I would like to have
9 marked and have Ms. Reed identify.

10 THE JUDGE: It will be Exhibit 23,
11 Ms. Deskins.

12 [Whereupon, Exhibit No. 23
13 was marked for identification by the judge.]

14 BY MS. DESKINS:

15 Q. Ms. Reed, could you identify what
16 Exhibit 23 is.

17 A. Yes, it's the information that we
18 put out at the end of each cost study period
19 to inform everyone of the cost for each
20 product, and it includes butter powder,
21 cheese and whey powder.

1 Q. And this is available on your web
2 page?

3 A. Yes, it is.

4 Q. I only have four copies of this. So
5 what I would like you to do is read what the
6 heading is of each table so people know what
7 the document is.

8 A. Okay.

9 Q. Just start out with the one I handed
10 you that's been marked as Exhibit 23.

11 A. Okay.

12 THE JUDGE: Just as a suggestion, Ms.
13 Deskins, she might also read into the record
14 at this time the web page.

15 BY MS. DESKINS:

16 Q. Yes. Could you give the web page
17 where this statistical information is
18 available.

19 WITNESS KRUG: The website is
20 www.cdfa -- www.cdfa.ca.gov/dairy.

21 BY MS. DESKINS:

1 Q. And just for the record, can you
2 tell us what CDFA stands for?

3 WITNESS KRUG: California Department
4 of Food and Agriculture.

5 Q. If you could read what the caption
6 is for each table so that people will know
7 what it is.

8 WITNESS REED: Okay. The first table
9 reads, Weighted Average Manufacturing Costs
10 for Butter, Nonfat Powder, Skim Whey Powder
11 and Cheddar Cheese, and that's from 1989
12 through 2005.

13 The next table is, Butter Processing
14 Costs, Released November 2005.

15 Nonfat Powder Processing Costs,
16 Released November 2005.

17 Cheese Processing Costs, Released
18 November 2005.

19 And Skim Whey Powder Processing
20 Costs, Released November 2005.

21 Q. Now, the first page of Exhibit 23 is

1 a letter from you to all interested parties?

2 [The following answers were made
3 by Witness Reed.]

4 A. Yes.

5 Q. Regarding the information that's
6 attached?

7 A. Right, yes.

8 Q. Has there been any updates to the
9 material that's contained in Exhibit 23?

10 A. Yes, there has.

11 Q. Could you please tell us what it is?

12 A. Yes. There was an update to the
13 powder processing cost page. There was a
14 change on -- in the processing labor area
15 and the general administrative areas.

16 Q. Can you tell us what -- what would
17 be the caption of the page in Exhibit 23
18 that they would refer to?

19 A. Nonfat Powder Processing Costs. And
20 on yours, it will say, Released November
21 2005.

1 Q. And this is the first table, is that
2 correct?

3 A. No, it is not. It is the powder --
4 it would be the third.

5 Q. Okay. And can you -- now, the
6 update is available on your web page, is
7 that correct?

8 A. Yes, it is.

9 Q. And can you just tell us for the
10 record how it changes the information that's
11 in Exhibit 23?

12 A. Okay. The first change will be on
13 the -- at the bottom of the page, under
14 Processing Labor, on the low cost line,
15 yours currently says .0327. The change is
16 .0291.

17 The next change would be on that same
18 row, under General and Administrative. Your
19 copy says .0099. The correct number now is
20 .0089. That would then change the weighted
21 average cost under Processing Labor from

1 .0364 to .0342, and it will change the
2 weighted average line under General and
3 Administrative from .0112 to .0106, which
4 would then change the total weighted average
5 cost from .1571 to .1543.

6 Oh, and also on that same line, under
7 Total Cost, on the low cost line, it was
8 .1419, and it is now .1373.

9 Q. Everything contained in Exhibit 23
10 other than, of course, your first page,
11 which is the letter, are statistics that are
12 maintained by the California Department of
13 Agriculture?

14 A. I'm sorry. Could you repeat.

15 Q. Everything that's contained in
16 Exhibit 23 except for, of course, the first
17 page, are statistics that are maintained by
18 the California Department of Agriculture?

19 A. Yes.

20 MS. DESKINS: Your Honor, at this
21 time, I would move for the admission of

1 Exhibits 21, 22 and 23.

2 THE WITNESS: There will be also a
3 change on the weighted average manufacturing
4 cost of the first report.

5 BY MS. DESKINS:

6 Q. Okay. And that's in Exhibit 23?

7 A. Yes, the very first one titled,
8 Weighted Average Manufacturing Costs for
9 Butter, Nonfat Powder, Skim Whey Powder and
10 Cheddar Cheese, 1989 through 2005. The
11 change would then be in the powder, the
12 nonfat powder, because that's the cost per
13 pound. And on yours, it is going to say
14 .1571. It is now .1543.

15 Q. Again, these updated figures are
16 available on your web page?

17 A. Yes, they are.

18 MS. DESKINS: Your Honor, at this
19 time, I would move for the admission of
20 Exhibits 21, 22 and 23.

21 THE JUDGE: There appears to be no

1 objection. They are admitted into evidence
2 at this time.

3 [Whereupon, Exhibits No. 21,
4 22 and 23 were received in evidence.]

5 MS. DESKINS: I have no further
6 questions of these witnesses. I do
7 appreciate their testifying at this time.

8 THE JUDGE: It does appear that the
9 noon hour is upon us. What is everyone's
10 pleasure for the length of time that you all
11 would like for the lunch break?

12 MEMBER OF THE AUDIENCE: We need at
13 least an hour and a half.

14 THE JUDGE: An hour and a half has
15 been suggested.

16 Mr. Beshore, is that okay with you?

17 MR. BESHORE: That's fine.

18 THE JUDGE: Mr. Vetne.

19 MR. VETNE: Yes.

20 THE JUDGE: Anybody else? All right.
21 We'll be back at 1:30, then.

1 [Whereupon, the hearing
2 recessed at 12:03 p.m. and reconvened at
3 1:27 p.m.]

4 THE JUDGE: Mr. Krug, Ms. Reed, you
5 are still under oath.

6 Is there any examination of these
7 witnesses? Mr. Yale?

8 MR. YALE: Yes.

9 THE JUDGE: Mr. Yale, as before, if
10 you would, please identify yourself one more
11 time.

12 MR. YALE: Benjamin F. Yale on behalf
13 of Select Milk Producers, Continental Dairy
14 Products and Dairy Producers of New Mexico.

15 THE JUDGE: Thank you, sir.

16 EXAMINATION

17 BY MR. YALE:

18 Q. Good afternoon.

19 [The following questions were
20 answered by Witness Reed.]

21 A. Good afternoon.

1 Q. It's nice to be able to ask
2 questions instead of having to answer them.
3 I've got a couple questions regarding the
4 study that you do. The comment is made is
5 that it's voluntary, the plants can choose or
6 not choose to participate in the program. Is
7 that correct?

8 A. Yes, that is correct.

9 Q. But once they choose to do so, your
10 office does a very thorough audit to make
11 sure those numbers are correct?

12 A. Well, we do a cost study.

13 Q. Okay.

14 A. But the figures that we use in our
15 cost studies have been audited by their
16 auditors prior to us using the figures.

17 Q. And in that process of doing that
18 cost study, do you have a program to make
19 sure that, whether inadvertent or
20 intentionally, that numbers are added or
21 subtracted from their -- the numbers that

1 they give you? In other words, do you have a
2 process to make that you see all the
3 information?

4 A. Well, yes. We see everything that
5 is needed to reconcile the figures for the
6 information that we are gathering, yes.

7 Q. When you do this -- you used the
8 word reconciliation. Do you do a
9 reconciliation to their audited numbers?

10 A. In some instances. In some
11 instances, there are other areas of the cost
12 study where we look at, for instance,
13 utilities, where we look at invoices and we
14 audit back to the actual cost, not what is in
15 their general ledger. So there are areas
16 that are -- where we take their audited
17 figures and reconcile back, and then there
18 are those that we do not.

19 Q. I guess to come back to a point, you
20 mentioned this report, and I think it was an
21 MP800 or some kind of report that they

1 prepare. You do some verification to ensure
2 that those numbers are correct?

3 A. The milk pooling branch does audits,
4 and they audit those figures to make sure
5 that those figures are correct before we go,
6 yes.

7 Q. Now, I notice in your -- I guess
8 this is directed to Mr. Krug.

9 Mr. Krug, your -- you make the
10 comment, and I think it is also part of the
11 report, that -- I guess it is in your -- it
12 mentions Monterey Jack. Could you explain
13 or, maybe it is, you, Ms. Reed, that needs
14 to explain the difference -- you know, you
15 include Monterey Jack in the analysis, as
16 well as cheddar. How does that factor into
17 the numbers?

18 WITNESS REED: Well, in the
19 production, if the plants have Monterey Jack
20 cheese, also, it is accounted for in the
21 number for the -- you know, for the total

1 production of the cheese.

2 So basically, the way that -- the
3 reason that they do -- that we do that is
4 because the process is basically the same.
5 And that's why it's included in the total
6 production when it comes to cheese cost. So
7 they -- but they might have other types of
8 cheese, but none of those would be accounted
9 for in the total production of cheese.

10 Q. Is the Monterey Jack included in
11 your yields or in your total production of
12 cheese that shows up on the report?

13 A. That's just cheddar.

14 Q. That's just cheddar?

15 A. The yields.

16 Q. So the assumption is, is that if you
17 are making Monterey Jack or you are making
18 cheddar, the cost is the same?

19 A. That is right. Yes, that is right.

20 Q. Are there any other cheeses that you
21 considered in this process? Are those the

1 only two?

2 A. Those are the only two.

3 Q. Now, do any of these plants produce
4 cheeses in addition to those American style,
5 these cheddars and Monterey Jacks?

6 A. Yes.

7 Q. And how do you separate those out?

8 A. Well, we get all of production
9 records, so we have to account for anything
10 that is produced, because we have to account
11 for the usage of the milk.

12 So basically, after we have given an
13 amount to -- you know, to -- of how much
14 milk was used and gone to those types of
15 cheeses, they are not costed out, but they
16 are shown on the usage portion of the receipt
17 in usage just to account for where the milk
18 went.

19 Q. And so you say -- you started
20 talking about -- do you do a mass balance?
21 Do you know what I mean by the term mass

1 balance?

2 A. No, you can explain it to me.

3 Q. Well, if you don't know what it is,
4 then I'm not going to follow up on the
5 question now. Maybe later I could explain
6 it, though.

7 So, in other words, you look at the
8 plant and you do a process to determine the
9 amount of milk that goes into non-American
10 style cheeses, separate that out and then
11 also try to ascribe the costs that are
12 associated with that process?

13 A. Yes. Yes, the cost will go to
14 those, also. Like I say, we don't cost them
15 out, nor are they on the exhibit, but we do
16 follow the cost all the way through because,
17 you know, the dollars will be allocated to
18 those types of cheeses as well as the
19 Cheddar and Monterey. But we are only
20 interested in costing those two types of
21 cheese.

1 Q. Now, I think you indicated that all
2 but just a small portion of the cheese
3 produced in California of cheddar and
4 Monterey Jack is subject to this cost
5 analysis; is that correct?

6 A. Well, yes. We accounted for 98.5
7 percent of the Cheddar and Monterey Jack
8 produced in California.

9 Q. Are these all cooperative plants?

10 A. No, they are not.

11 Q. Do you know what the percentage is
12 that's cooperative and what percentage is
13 proprietary?

14 A. Not off the top of my head, no.

15 Q. I think your testimony was you
16 actually make an inspection. So you
17 physically have reviewed the plant to see to
18 it how the process works so you can tie that
19 into their costs?

20 A. Yes, that is correct.

21 Q. Now, I kind of want to change

1 subjects here a little bit and kind of talk
2 about the California system. You also, not
3 necessarily you, personally, but CDFA also
4 does an analysis of producer cost as well, do
5 you not?

6 WITNESS KRUG: Yes, we do.

7 Q. And is that number considered in the
8 process of making the decision of what the
9 make allowances would be?

10 WITNESS KRUG: It is setting the
11 formulas that's considered but not
12 necessarily the make allowance.

13 Q. Right. In other words, you have a
14 make allowance that you determine based on
15 the audit. But the make allowance within the
16 formulas that you use, that decision is based
17 upon factors other than just what these
18 audited make allowances are. Is that a
19 correct statement?

20 [The following answers were
21 given by Witness Krug.]

1 A. Yes.

2 Q. And what are some of those other
3 factors?

4 A. Supply, demand, relationship between
5 classes. There are many factors that are
6 considered.

7 Q. So it becomes a policy decision at
8 some point. Is that correct?

9 A. Yes.

10 Q. It is not a mechanical process?

11 A. Correct.

12 Q. Now, in California, do the cheese
13 plants have to pay the state minimum prices
14 that you guys set by your formulas, the state
15 minimum prices?

16 A. For market milk, they do.

17 Q. For market milk? And what is market
18 milk?

19 A. Market milk is milk that is used in
20 the higher classes but can also be used in
21 all classes of milk. There is a distinction

1 with Grade B or manufactured milk, which is
2 -- has restricted use in lower class.

3 Q. Market milk is equivalent to our
4 Grade A?

5 A. Similar to Grade A.

6 Q. Similar to Grade A. So a cheese
7 plant in California doesn't have the option
8 to purchase milk under these minimum prices
9 if it wishes to?

10 A. Yes, they do if they use
11 manufacturers' milk.

12 Q. But if they -- market grade milk,
13 they don't?

14 A. That is correct.

15 MR. YALE: One second.

16 BY MR. YALE:

17 Q. In the -- have you also done a study
18 to analyze the actual prices at which
19 producers sell -- or not producers, plants
20 sell their product for?

21 A. We do many studies. Maybe you could

1 be a little more --

2 Q. I believe there was a report that
3 was presented not too long ago where you
4 compared it to the CME, prices at which the
5 plant was selling some of the cheeses?

6 A. Well, that possibly could have been
7 done with the last make allowance hearing
8 that we did.

9 Q. And the reason for that study was
10 what?

11 A. Well, I don't have in mind the exact
12 study that you are referring to. I am
13 generally aware that we have done studies
14 like that at times when we have had our
15 hearings open for make allowance for Class IV
16 before A. And I think the ones I am familiar
17 with have to do with, you know,
18 transportation issues. Anyway, just general
19 formula levels and some of the other
20 considerations that were taken into account
21 for policy setting reasons.

1 Q. Now, the -- at this website that you
2 mentioned today, there is a link that would
3 take one to the price formulas that you used
4 in your current minimum pricing; is that
5 correct?

6 A. Yes. The website was just updated,
7 and I haven't looked at it. Since it was
8 updated, I assume it has a link to the
9 formula explanation.

10 Q. And in your cheese formula, do you
11 have a yield for all the cheese or do you
12 have a yield like you do in the federal,
13 where they look at the butter and the
14 protein? Do you just do all the solids, not
15 fat, or do you break it down between butter
16 and protein?

17 A. We have a butter component and a
18 solids component.

19 Q. And is that butter component just
20 for the whey butter?

21 A. I believe it is not. I believe it

1 is for -- it covers the fat portion of the
2 formula.

3 Q. You take so much a yield for the
4 protein and the yield for the butterfat and
5 --

6 A. Right.

7 Q. Okay. Now, on your exhibit of the
8 California numbers, rather the cheese
9 processing costs -- I think it's Exhibit 23
10 -- you have specific yields that you have
11 averaged out. I think it is noted in
12 footnote No. 8. Do you see that?

13 A. Yes.

14 Q. Now, that -- first of all, my
15 question is, that's strictly cheddar cheese?

16 A. Yes, it is.

17 Q. And you also indicate that that's
18 with a 4.02 percent fat and a 9.05 percent
19 solids nonfat in the vat?

20 WITNESS REED: Yes.

21 Q. Now, does your formula -- are you

1 recognizing the fact that whey butter and
2 butter is recycled in the processing system
3 for your formulas for this yield?

4 [The following answers were
5 given by Witness Reed.]

6 A. Well, the formulas that -- the
7 yields that are referred to on here are
8 yields that come from information that we get
9 from the plants. It is not a part of the
10 formula or anything else like that. We get
11 information from the plants on the finished
12 yields for all of their different cheeses,
13 basically.

14 Q. But you work this out for just the
15 cheddar?

16 A. Yes, that is right. That's all that
17 is.

18 Q. Now, you also note there, in
19 paragraph or note No. 7, that 62 percent of
20 the cheese was processed at a cost less than
21 the manufacturing cost allowance?

1 A. Yes.

2 Q. Now, when you say manufactures cost
3 allowance, is that the same thing as the
4 total cost in the columns below?

5 A. The -- the 171, you are asking?

6 Q. Or the .1769?

7 A. Yes, that's the weighted average,
8 total cost.

9 Q. So you are saying 62 percent of
10 cheese is processed at a cost less than
11 that?

12 A. At a cost less than the 171.

13 Q. The 171?

14 A. Yes.

15 Q. Okay. And which includes
16 administration and return on investment; is
17 that right?

18 A. Yes, it does.

19 Q. Do you do a profit and loss analysis
20 of the plants to determine whether they are
21 profitable or not?

1 A. No, we don't.

2 Q. Now, in your footnote 5, you talk
3 about packaging costs that you use to adjust
4 for the 500-pound barrels for the 640-pound
5 blocks, okay. First of all, for those two,
6 do you do an adjustment for the moisture
7 that's in the cheese for the 500 pounds and
8 the 640s?

9 A. No, there is no adjustment made.

10 Q. For moisture?

11 A. No.

12 Q. Okay. And how do you come up with
13 the -- how do you make this adjustment? I
14 assume that what you are saying here is you
15 are taking the cost to produce 500-pound
16 barrels and you are trying to equate it to
17 what that would be if it was a 40-pound
18 block. Is that right?

19 A. Yes, exactly. Basically, if the
20 plants do not make 40-pound blocks and only
21 make 500-pound barrels or whatever, all of

1 the other expenses are basically the same for
2 a 40-pound plant or a 500-pound plant except
3 the labor and packaging. So what is done is
4 a weighted average of all those plants that
5 do 40-pound blocks for processing labor and
6 then also for packaging expenses. And then
7 those figures are put into the expenses for
8 the 500-pound plants, and then that is how we
9 get a 40 pound price for that plant, okay.

10 Q. Would you be able to state what the
11 range is from the smallest to the largest
12 plant in this survey besides the cheese? I
13 don't need to know the name of the plant,
14 but the production of the smallest to the
15 largest.

16 WITNESS KRUG: Only if it happened to
17 be what the lowest is on our sheet. We are
18 not going to go into any more detail than
19 what we have presented in the exhibit.

20 Q. Now, how do you handle whey within
21 the plant?

1 WITNESS REED: Well, you need to
2 maybe clear that up a little bit.

3 Q. Let's back up. In the process of
4 making Cheddar cheese, one of the by
5 products is whey. Is that correct?

6 WITNESS REED: Yes.

7 Q. And historically, or in the past,
8 whey was a disposal issue; is that right?

9 WITNESS REED: Yes, it was.

10 WITNESS KRUG: In some cases.

11 Q. In some cases. In some cases, it is
12 still disposed. In others, it's turned into
13 a product, a raw product or a finished
14 product. Is that right?

15 WITNESS REED: Yes.

16 Q. So how do you handle dealing with
17 whey in this cost analysis?

18 [The following answers were
19 given by Witness Reed.]

20 A. Okay. If a plant does not process
21 anything from its whey and it is just

1 disposed, then those costs are captured in
2 their disposal fees, usually. They will have
3 higher disposal fees, so that will be a
4 nonlabor. Also, that plant loss will be then
5 reapplied in receipts and usage. The plant
6 loss would be reapplied to the cheese, low
7 fat and solids nonfat.

8 In plants that process whey products,
9 then there is usually very little disposal,
10 and -- but they still have some, but there is
11 little disposal fees, but those disposal fees
12 still are, you know, applied in nonlabor.

13 And then the butterfat and solids
14 nonfat associated with those products are
15 tacked onto those whey products, not thrown
16 back in the cheese if they are, you know,
17 viable products.

18 Q. Like you did on the barrels, you
19 know, the block barrels and 640s to the
20 40-pound blocks, do you do any adjustment
21 between plants that have purely disposal of

1 whey to those who process whey?

2 A. No.

3 Q. I'm not familiar with California's
4 environmental issues, but disposal of whey
5 can be a very expensive process; is that
6 right?

7 A. Extremely.

8 Q. Can you give us any percentage of
9 plants in this study that dispose of their
10 whey as opposed to process it?

11 A. Not without looking it up, no, I am
12 not sure. They all have some, but not
13 anything like it used to be.

14 Q. Looking at this whey, the skim whey
15 processing cost, when you talk about skim
16 whey powder, what is the percentage of dry
17 matter that's used for that process? Do you
18 know?

19 WITNESS KRUG: I'm not sure.

20 WITNESS REED: I'm not sure, either.

21 Q. Do you know what percent of that is

1 whey?

2 WITNESS KRUG: No.

3 Q. Now, in your nonfat dry milk
4 processing, how do you account for dried
5 buttermilk? Or do you account for dried
6 buttermilk?

7 [The following answers were
8 given by Witness Reed.]

9 A. If they make it, then we account for
10 it. It would not be included in the nonfat
11 dry milk powder; it would be separate. And
12 we -- the same processes that we do nonfat
13 dry milk powder, you know, it's from their
14 production records, butterfat and solids
15 nonfat. We get that information from them,
16 and then costs are allocated to that, also,
17 so that it is not put onto regular nonfat dry
18 powder. But it's just the same way.

19 Q. So these yields or these prices are
20 strictly and purely for the --

21 A. Nonfat dry milk powder only, yes.

1 Q. Now, in California, I notice you use
2 the CME for your cheese, but how do you do --
3 what pricing series do you use for the nonfat
4 dry milk?

5 WITNESS KRUG: We use a California
6 weighted average price.

7 Q. And how is that computed or derived
8 or collected?

9 WITNESS KRUG: Survey of sales from
10 plants.

11 Q. And what percentage of sales are
12 included in that?

13 WITNESS KRUG: Very high. I don't
14 know the percentage, but it is -- it would
15 be the vast majority of the market.

16 Q. I want to switch back over to the
17 cheese operations. How do you deal with aged
18 cheeses, aged Cheddars? Are those separated
19 from these cheddars for shredding or are
20 they all the same?

21 [The following answers were

1 given by Witness Reed.]

2 A. They are basically all the same,
3 because once they are made, we don't carry
4 it out. I mean, we are not costing for the
5 time that it sits in a warehouse and all
6 that. So they are all basically the same.

7 Q. But you don't separate out the
8 processing -- if it is cheddar, even though
9 it is going to be made for aging, you treat
10 that as if it's -- all cheddar is the same?

11 A. Yes.

12 MR. YALE: At this point, I don't
13 have any questions. Thank you.

14 THE JUDGE: Very well. Other
15 examination? Mr. Vetne.

16 EXAMINATION

17 BY MR. VETNE:

18 Q. Good afternoon. I'm John Vetne,
19 attorney for Agri-Mark and Northwest Dairy
20 Association.

21 In response to questions from Ben

1 Yale, the two of you, in dialogue, used the
2 word disposal in relation to the whey
3 byproduct produced by cheese plants.

4 My question is, when you were
5 answering those questions, did you, in your
6 minds, consider disposal to be land spreading
7 or other disposal as waste or simply removal
8 of the whey from the plant?

9 WITNESS REED: I didn't think of it
10 either way. Disposal, basically, I consider
11 it being removal of the whey from the plant.

12 WITNESS KRUG: Disposing of it.

13 WITNESS REED: Disposing of it.

14 Q. So in response to both questions,
15 you were referring to cheese plants that do
16 not process their own whey but do something
17 else with it, correct?

18 [The following answers were
19 given by Witness Reed.]

20 A. Well, I'm -- what I'm talking about
21 is when they, in the past, disposed of it,

1 they did not sell it to anyone or anything.
2 They would just simply dispose of it in the
3 sewer.

4 Q. Down the drain?

5 A. Yes.

6 Q. Currently, though, are you aware
7 that there are plants in California making
8 cheese but do not produce any whey products,
9 that dispose of their whey by trucking it
10 some place, either in whole or condensed
11 form?

12 A. I know that there are plants that do
13 not make whey products, yes, but what they do
14 with it, I cannot answer.

15 Q. All right. Let me ask you this. Of
16 the plants included in the whey survey, and
17 there were three plants, are all of those
18 plants plant that produce both cheese and a
19 whey byproduct?

20 A. Yes.

21 Q. There were no -- you did not survey

1 any stand-alone whey plants?

2 A. No, I didn't.

3 Q. You didn't survey any milk drying
4 plants that produce both nonfat dry milk and
5 buttermilk powder and whey products?

6 A. No.

7 Q. Mr. Yale also asked you some
8 questions from your survey. I think he
9 referred to some questions about yield and
10 the percentage of solids not fat and fat in
11 the vat.

12 I wanted to ask you some questions
13 about the vat numbers reported. Is it not
14 the case that cheese plants in California
15 receive milk that is either fortified with
16 solids not fat or concentrated in some way
17 delivered into their vat?

18 A. Well, they fortify them themselves,
19 I know of. I don't know about receiving the
20 milk. Some do receive some fortified milk,
21 yes. I'll take that back.

1 Q. So the milk in the vat that is
2 reported in your survey, and for the solids
3 not fat percentage, 9 percent plus, would
4 include the results of fortification, whether
5 it was by the plant operator or by receiving
6 concentrated milk?

7 A. Yes.

8 Q. And the 4 percent plus butterfat of
9 milk in the vat would reflect receipts of
10 cream?

11 A. Yes, it can.

12 Q. The average of -- in excess of 4
13 percent butterfat and combined with an excess
14 of 9 percent solids not fat is higher than
15 the yearly average component contents of
16 producer milk, correct?

17 A. Yes.

18 Q. The survey data reported in exhibit
19 -- what is the survey?

20 THE JUDGE: Exhibit 23.

21 BY MR. VETNE:

1 Q. Exhibit 23. Are all those costs as
2 well as the bottom line data surveyed for
3 the calendar year 2004, but reported in
4 2005?

5 A. Yes, the bottom line is for that
6 only, for 2004.

7 Q. In the middle of the cover letter to
8 interested parties, there is a notation, "In
9 addition, the weighted average manufacturing
10 for whey is shown for 2004 and 2005." How
11 does 2005 enter into the survey when the
12 release was made before the end of 2005?

13 A. One of the plants is not on a
14 calendar year. We take 12 months, but it
15 goes into the next year, basically. But we
16 are going to change that for the future.

17 So that's just a -- they were a new
18 startup plant, and we had to start where we
19 could with collecting the information,
20 basically.

21 Q. Okay. So one of the three months

1 was surveyed for 12 months, and the last --
2 and the twelfth month occurred in 2005?

3 A. That is correct.

4 Q. Do you know what month of 2005 that
5 was?

6 A. Let me read this again, okay? Hold
7 on. Okay. Just one second.

8 [Reviewing.]

9 It's November through -- would it be
10 February? I'm not sure. I'd have to think.
11 I'm not sure. I don't have it here. I'm
12 not positive. I'm not sure what the dates
13 are for that one particular place.

14 Q. You don't know what the last
15 reporting or last survey month is?

16 A. No, I don't because I don't have it
17 on here. I know which plant it is, but I
18 don't have the dates on here.

19 Q. Okay. Do you have any feeling on
20 how much time lapsed between the gathering
21 of that information from that plant and the

1 publication of the report? Do you have a
2 range? I mean, how quickly would you be
3 able to produce the numbers after you had the
4 data?

5 A. Well, we gather the information --
6 like this year, we'll start probably in
7 February or March, whenever they have their
8 records available to us. And then the
9 information is usually released, and I --
10 this might be in error. I need to really
11 check this out. The information is then
12 released in November of that year. So from
13 March to November, basically.

14 Q. Okay. So it is usually released in
15 about the middle of the fall. And when
16 those numbers reveal a change in
17 manufacturing costs, what is the lag between
18 the release of that data and the
19 implementation of that new cost information
20 into the pricing scheme?

21 WITNESS KRUG: That really varies,

1 depending on the interest level, depending on
2 the size of the difference. The information
3 was released in November for the 2004, the
4 most recent year. Our Department hasn't
5 been petitioned to hold a hearing on this
6 matter at this point, about two months later.
7 So it really varies.

8 Q. So tell me if I'm correct, Mr. Krug.
9 Although CDFA gathers surveys, gathers and
10 reports the manufacturing costs information,
11 it is not automatically incorporated into
12 the pricing formula unless there is a
13 hearing?

14 WITNESS KRUG: A hearing would have
15 to be held. It's not automatic.

16 Q. Okay. And what is the ordinary time
17 between the close of a hearing and the
18 implementation of an amended price formula in
19 California?

20 [The following answers were
21 given by Witness Krug.]

1 A. It is approximately two months.

2 Q. And that includes consideration of
3 posthearing briefs?

4 A. Yes.

5 Q. And it includes a panel making a
6 recommendation to the policymaker, correct?

7 A. Yes.

8 Q. And then the policymaker takes that
9 recommendation and either adopts it, modifies
10 it or rejects it, correct?

11 A. That is correct.

12 Q. So it is the --

13 A. And it includes a 10-day notice to
14 the affected handlers.

15 Q. A 10-day notice from the decision of
16 the policymaker announcing a change?

17 A. Yes, from the close of hearing until
18 implementation.

19 Q. There was reference to the 800
20 report by Mr. Yale or -- is that the
21 California report of receipts and utilization

1 by regulated handlers?

2 WITNESS REED: Yes, it is.

3 I can answer your other question now.

4 I needed a few seconds to refresh my memory.

5 Q. The question being, what was the
6 last date of survey included in the whey?

7 [The following answers were
8 given by Witness Reed.]

9 A. Exactly. What this letter refers
10 to, it says, In addition, the weighted
11 average manufacturing for whey is shown for
12 2004 and 2005. These years are the years
13 that they are released, but the information
14 is for the prior year. So if it says 2004,
15 that's 2003 information. If it says 2005,
16 that's 2004 information.

17 So none of the information for whey
18 is of information from 2005, but it is
19 released in 2005. I just wanted to make that
20 --

21 Q. Okay. So it is all survey and cost

1 information predating January 2005?

2 A. Yes.

3 Q. As I recall, the gathering of the
4 whey cost information started in the middle
5 of -- not at the beginning of 2003. So it is
6 not 24 months of whey data, but it is more
7 than 12?

8 A. Well, each year -- 2004 represents
9 12 months, and 2005 represents 12 months,
10 also.

11 Q. Talking about just the whey
12 component of the cost studies and surveys.
13 Did that not start --

14 A. Right.

15 Q. -- some place other than --

16 A. Yes, it is; 14 months, I think, on
17 this particular one.

18 Q. Okay. I'm looking at page 2 of the
19 1989 to 2005 manufacturing cost summary.
20 And I refer you to the 2001 release which
21 has a footnote 2, which indicates a utility

1 cost adjustment being made for energy costs
2 in August of 2001, which was probably about
3 two or three months before the data was
4 released.

5 As I read that footnote, maybe I
6 should -- it would be -- I think it -- if
7 it's what I think it means, it means for the
8 year 2001, you used cost surveys through,
9 what, 1999-2000. But for that one
10 component, which is part of one of the lines,
11 you made a very recent, current update. Is
12 that correct?

13 WITNESS KRUG: Yes, it is.

14 Q. Okay. And that same process was
15 used again -- let's see. It looks like
16 footnote No. 4, which would be the 2002
17 release, cost data through December 2001,
18 except for utility which, again, you drew a
19 more recent number to reflect current utility
20 costs.

21 WITNESS KRUG: And I believe, also,

1 wages, payroll, taxes, fringe benefits.

2 Q. Oh, you added a couple more --
3 again, more current updates of line items.

4 WITNESS REED: Yes.

5 Q. Was there anything happening in
6 California to utility costs during those two
7 reporting periods or release periods which
8 caused you to isolate utilities to make a
9 more current adjustment?

10 WITNESS KRUG: There was a lot of
11 interest in especially energy costs changing
12 rapidly, escalating rapidly.

13 Q. There was a hearing on make
14 allowance in 2003, correct?

15 WITNESS KRUG: I don't have my dates
16 exact, but I believe that is correct, yes.

17 Q. And there was a more recent one in
18 January of 2005?

19 WITNESS KRUG: Correct.

20 Q. And in both of the two recent
21 hearings, make allowances in the formula

1 have been adjusted as a result of the
2 hearing, correct?

3 WITNESS KRUG: Yes.

4 Q. And in both cases, the pricing
5 formula was put into effect within 60 days
6 after the close of the hearing, correct?

7 WITNESS KRUG: Yes it was.

8 MR. VETNE: I very much appreciate
9 your being here.

10 Oh, I do have one thing, Your Honor.
11 During the luncheon break, I went and made
12 copies of the update, which I think would be
13 helpful to have a physical record. I
14 distributed, actually, these, along with the
15 November release, broadly to the room.

16 So if I could have the update marked
17 as the next consecutive exhibit --

18 THE JUDGE: It will be Exhibit 24.

19 MR. VETNE: Maybe you can just verify
20 that that's the right thing.

21 [Whereupon, Exhibit No. 24

1 was marked for identification by the judge.]

2 BY MR. VETNE:

3 Q. Can you verify that that's --

4 WITNESS REED: Yes, it is.

5 MR. VETNE: Your Honor, I ask that
6 Exhibit 24 be received.

7 THE JUDGE: Exhibit 24 will be
8 admitted.

9 Other examination of these witnesses?

10 DR. CRYAN: I'm Roger Cryan. I'm
11 with National Milk Producers Federation.

12 I actually have some copies of the
13 update, including the cover letter that
14 arrived in the mail yesterday. And I wanted
15 to -- if that's okay, I would like to offer
16 that. I don't have very many copies. This
17 is a little redundant but a little more
18 complete.

19 THE JUDGE: Very well. It will be
20 marked as Exhibit 25.

21 [Whereupon, Exhibit 25 was

1 marked for identification by the judge.]

2 DR. CRYAN: And I would ask if Ms.
3 Reed would confirm that that's the accurate
4 update.

5 WITNESS REED: Yes, this is correct.

6 DR. CRYAN: Thank you very much.

7 EXAMINATION

8 BY DR. CRYAN:

9 Q. Ms. Reed, obviously, you guys do a
10 very good job putting together a very
11 detailed and closely controlled study.

12 I have some -- I understand when you
13 do a survey, some of the details that you
14 collect from the plants, although they are
15 not in the normal publication of the data,
16 is detail on fuels and electricity costs.
17 Is that correct?

18 A. By special request, it would.

19 Q. I'm sorry. Gas and electricity.
20 Okay.

21 A. Yes.

1 DR. CRYAN: And I have another paper
2 I would like to offer. I only have a few,
3 but I could bring more tomorrow. This is a
4 two-sided sheet of paper. On the first side
5 is the table.

6 THE JUDGE: Why don't you ask her if
7 she can identify it first.

8 DR. CRYAN: I'm going to explain it
9 and then ask her if she confirms that that's
10 what it is. Is that all right?

11 THE JUDGE: All right.

12 DR. CRYAN: Thank you.

13 BY DR. CRYAN:

14 Q. On one side, the first -- one side
15 is labeled, Sent by Venetta Reed, CDFA, to
16 Neil Gulden, AMPI, by E-mail January 20,
17 2006. And I apologize for misspelling your
18 name on the heading.

19 A. That's all right.

20 Q. But below that heading, would you
21 identify that table?

1 A. I'm just checking the numbers real
2 quick.

3 [Reviewing.]

4 Q. The one identified as by e-mail, is
5 that the one you are looking at? Or are you
6 looking at the other side?

7 A. Yes, I recognize this one as
8 accurate.

9 Q. Thank you. So that is the table you
10 sent to Neil as the electricity and gas
11 costs for low cost, medium cost and high cost
12 groups of powder producers, low cost and high
13 cost groups of butter producers, and low cost
14 and high cost groups of cheese makers?

15 A. Yes.

16 Q. And are those groups, those high
17 cost and low cost and medium cost groups,
18 are those -- do those represent the same
19 groups that are broken out in the exhibit,
20 the previous exhibit?

21 A. Yes.

1 Q. Thank you.

2 On the other side of the sheet, the
3 heading is, Provided by Venetta Reed, CDFA,
4 to Neil Gulden, AMPI, by Phone, and it's
5 dated January 20, 2006.

6 There are four sets of numbers there
7 that -- all the numbers there in -- the
8 numbers that are not in italics are the
9 numbers that I understand you offered and you
10 gave Neil over the phone. The number in
11 italics is the number that I have calculated
12 from the previous table.

13 And first of all, I would like to ask
14 you whether you can identify those numbers.

15 A. Well, yes, I can. And actually, I
16 was going to ask where the .0043 came from
17 myself, because I have the .0078 that you
18 have italicized.

19 Q. Okay. So that was a transcription
20 error --

21 A. Yes.

1 Q. -- probably on my part?

2 A. Yes.

3 Q. So if we cross out the .0043 --

4 A. Yes.

5 Q. -- you would identify those numbers
6 as the same numbers as you -- as your numbers
7 respecting electricity and gas costs for the
8 four categories of plant?

9 A. Yes.

10 DR. CRYAN: Okay. Thank you very
11 much. That's all I have. Thank you very
12 much.

13 Oh, I'm sorry. I have got one --
14 could I ask that that --

15 THE JUDGE: Exhibits 25 and 26 will
16 be admitted into evidence.

17 DR. CYAN: Thank you.

18 [Whereupon, Exhibits No. 25
19 and 26 were received in evidence.]

20 THE JUDGE: Mr. Beshore.

21 No. 26 is the two-sided one, which is

1 information provided by Ms. Reed. And the
2 other one is the same thing as 24 except with
3 the cover letter.

4 EXAMINATION

5 BY MR. BESHORE:

6 Q. Marvin Beshore.

7 Ms. Reed, I have just a couple of
8 more questions about Exhibit 26 which Dr.
9 Cryan just inquired about.

10 A. Okay.

11 Q. First of all, is the -- what year is
12 the year in which these costs figures were
13 derived from? Is it from 2004 data?

14 A. Yes, it is.

15 Q. And taking the first page, 26, the
16 information relating to electricity and gas
17 costs, are those costs per pound of commodity
18 in each case?

19 A. Yes, it is.

20 Q. Going to the second page, then, the
21 back page, is this also from 2004 cost data?

1 A. Yes, it is.

2 Q. And the electricity and gas costs
3 are, in each case, per pound of commodity?

4 A. Yes.

5 Q. These figures were from the same
6 database of information from which your more
7 complete processing costs released, this 23,
8 24 and 25, were produced?

9 A. Yes.

10 Q. Thank you very much.

11 A. Thank you.

12 THE JUDGE: Other examination?

13 Mr. Yale.

14 EXAMINATION

15 BY MR. YALE:

16 Q. In the -- first of all, Benjamin
17 Yale for Select Milk, Continental Dairy
18 Products and Dairy Producers of New Mexico.

19 On the cheese processing cost of your
20 exhibit -- and I believe that's 23 -- you
21 have the volume in the group below cost and

1 the volume in the group for high cost?

2 [The following answers were
3 given by Witness Reed.]

4 A. Yes.

5 Q. And the average that -- is this
6 volume -- this is an annual volume?

7 A. Yes, it's for the 12-month period.

8 Q. And I would note that, you know, if
9 you divide that out, that you come up with an
10 average plant of about 209, give or take,
11 million pounds per year on an average of
12 those three plants versus about a little
13 less than 50 million for the one below that.

14 Does that look right for the high
15 cost in terms of the average size of the
16 plants?

17 A. No. Not necessarily, no.

18 Q. Okay. What do you mean by not
19 necessarily? What do you mean?

20 A. I mean that the low cost plants
21 don't -- each one of them don't necessarily

1 make two hundred and some odd million pounds
2 of cheese.

3 Q. But the three of them average do?

4 A. Yes. If you are doing just a simple
5 average, yes.

6 Q. All right. My question is, do you
7 see generally a correlation between size of
8 operation and the cost to produce product?

9 A. Definitely.

10 Q. And the much larger ones tend to
11 produce at the lower cost?

12 A. Yes.

13 Q. The other part, you do not do any
14 studies of any plants outside of California?

15 A. No, we don't.

16 Q. And you don't make any
17 representation that this is what the cost
18 would be to produce cheese in any other part
19 of the country?

20 A. No, we don't.

21 MR. YALE: That's all I have.

1 THE JUDGE: Other examination of this
2 witness?

3 Very well. It looks like you may
4 step down.

5 Ms. Deskins.

6 MS. DESKINS: I just wanted to thank
7 the witnesses for coming. We appreciate
8 your testimony about the cost studies from
9 California.

10 MR. RASTGOUFARD: Babak Rastgoufard,
11 USDA. I would put on our last witness,
12 Howard McDowell.

13 THE JUDGE: Mr. McDowell.

14 [Whereupon, the witness was
15 duly sworn by the judge.]

16 THE JUDGE: Please be seated and tell
17 us your name and spell your last name for the
18 hearing reporter.

19 THE WITNESS: My name is Howard
20 McDowell. M-C-D-O-W-E-L-L.

21 EXAMINATION

1 BY MR. RASTGOUFARD:

2 Q. Good afternoon. Can you please
3 state for the record your job title and
4 employer?

5 A. I'm a senior economist in the
6 Economic Analysis Staff, Dairy Programs at
7 USDA.

8 Q. And your duties in that capacity?

9 A. A variety of responsibility in the
10 area of economic analysis of dairy issues
11 and, in particular, certain Federal order of
12 proceedings and other dairy issues in the
13 Department.

14 Q. And also, for the record, can you
15 please describe your educational background?

16 A. I have a bachelor's and a master's
17 degree from Virginia Tech and a Ph.D. in
18 agricultural and applied economics from the
19 University of Minnesota.

20 Q. Thank you. I understand you have a
21 prepared statement that you would like to

1 enter into the record. I have copies of
2 that.

3 THE JUDGE: It has been marked as
4 Exhibit 27.

5 [Whereupon, Exhibit No. 27
6 was marked for identification by the judge.]

7 THE JUDGE: Counsel, do you want to
8 also mark the Econometric Baseline Model
9 Documentation?

10 MR. RASTGOUFARD: Sure. Might as
11 well.

12 THE JUDGE: That will be 28.

13 [Whereupon, Exhibit No. 28
14 was marked for identification by the judge.]

15 BY MR. RASTGOUFARD:

16 Q. Can you enter your statement
17 into the record at this time?

18 STATEMENT FOR THE RECORD BY MR. MCDOWELL

19

20 My name is Howard McDowell. I am the
21 Senior Economist on the Economic Analysis

1 Staff in Dairy Programs of the Agricultural
2 Marketing Service of the United States
3 Department of Agriculture. I have been the
4 Senior Economist since 1999 when I joined
5 Dairy Programs.

6 The preliminary analysis reported in
7 the hearing announcement was done by the
8 Economic Analysis Staff under my supervision.
9 The analysis was done using Dairy Programs
10 Baseline Econometric Model and the model was
11 calibrated from the baseline that USDA
12 published in February 2005. In addition to
13 the summary tables published in the hearing
14 notice, an Appendix including more details
15 tables and a documentation of the model have
16 been posted on the Dairy Programs website
17 and, I understand, entered as an exhibit
18 here. I am here to answer questions that
19 you may have concerning the preliminary
20 analysis.

21 Q. And just for the record, the

1 appendix which was just referred to has been
2 entered into the record as Exhibit 2.

3 And also for the record, just to be
4 clear, when you refer to the hearing
5 announcement, you are referring to the
6 federal register notice that came out on
7 January 5th, 2006 --

8 A. That is correct.

9 Q. -- marked as Exhibit 1.

10 Were you asked to prepare any
11 information for this hearing?

12 A. We were asked to do this preliminary
13 analysis, and we proceeded to do that.

14 Q. And can you please explain why this
15 analysis was prepared?

16 A. Executive order 12866 requires that
17 for significant -- for federal regulatory
18 actions that have significance defined as
19 over a hundred million dollars of impact,
20 there shall be a preliminary analysis done.
21 It appeared that that might be the case, so

1 we proceeded with it.

2 Q. And so, this analysis was just for
3 illustrative purposes?

4 A. That is correct.

5 MR. RASTGOUFARD: I would like to
6 move both, I guess, Exhibit 27, the
7 statement, and 28, the baseline model, into
8 the record.

9 THE JUDGE: Objection? There being
10 none, 27 and 28 will be introduced or
11 admitted at this time.

12 [Whereupon, Exhibits No. 27
13 and 28 were received in evidence.]

14 BY MR. RASTGOUFARD:

15 Q. Is there anything else you would
16 like to add regarding either the analysis or
17 the baseline model?

18 A. No, sir.

19 Q. Thank you. No further questions.

20 THE JUDGE: Very well. Questions?
21 Mr. Vetne.

1 EXAMINATION

2 BY MR. VETNE:

3 Q. John Vetne, representing Agri-Mark.

4 I tremble when I ask questions of
5 witnesses who use words and symbols that I
6 don't know. That might also be helpful.

7 I just -- I went to the last page.
8 Table 7, page 10. The title of Table 7 is,
9 Class I Over Order Payments All Milk Price.
10 What does that intend to capture? What does
11 that title mean?

12 A. Several equations in that table
13 right there, the last of which is the
14 equation that we are using to estimate the
15 all milk price. As a portion of the all
16 milk price, we are also -- in that equation
17 is the -- our estimate of Class I over-order
18 payments.

19 So what we are doing in this table
20 is, first, showing you the equation that we
21 use to estimate over-order payments, which

1 is a function of cheese production and fluid
2 milk per capita consumption.

3 Q. Stop right there. The Class I
4 over-order payments are a function of cheese
5 production? How?

6 A. We generally think about over-order
7 payments being the amount that processors
8 pay over and above minimum Class I price.

9 Q. Would include milk processors?

10 A. That is correct. And one of the
11 variables that's involved in that is how
12 scarce milk is. And so, in many cases, the
13 over-order payment is directly related to
14 the give-up charges that need to be paid to
15 primarily cheese makers in order to free milk
16 up.

17 So it is a -- this equation is trying
18 to reflect the market balance of milk.

19 Q. What does the word intercept mean?
20 It's used in several places in your exhibit.

21 A. The equations that we are estimating

1 here will include key parameters. In this
2 case, the key parameters, or the key
3 variables, rather, are total cheese
4 production and fluid milk per capita
5 consumption.

6 And then, whenever you are involved
7 in estimating equations with linear
8 regression, you have to have an intercept
9 usually, or you can specify there is no
10 intercept. And so, that helps to position
11 the curve in space.

12 Q. What is the function of the
13 intercept -- sorry. Can you explain it to
14 me as though I'm in fourth grade, or maybe
15 eighth.

16 A. These squares regression fits a line
17 through a scattering of points. You can
18 think of it on a piece of paper with the
19 vertical axis being the Y axis.

20 Q. Actually, those points, yes.

21 A. Okay. And the horizontal would be

1 the X axis.

2 Now, what the statistical procedure
3 does is minimizes the square differences
4 between the fit line and all the points.

5 And in order to fit that line through X, Y
6 space, you bring it back against the Y axis,
7 and that is an intercept.

8 Q. All right.

9 A. And that's why sometimes it can be a
10 negative, and sometimes it can be positive.

11 Q. Okay. Now, does it -- somewhere on
12 this table, are -- any of the numbers show
13 your estimated impact on Class I over-order
14 premiums?

15 A. No.

16 Q. No, it doesn't? Okay.

17 A. It's a specification of the equation
18 that is in the model.

19 Q. Okay. And does Table 7 show a
20 bottom line impact on all milk prices?

21 A. No, sir, it does not. The final

1 equation there is the equation that is used
2 in the model to estimate the all milk price
3 as a portion of everything else that is
4 going on in the model.

5 Q. Okay. Is there someplace else in
6 the exhibit where your projections translate
7 to either absolute or relative impact on
8 milk price?

9 A. This particular exhibit that you are
10 looking at is a specification of the model.
11 In it is a listing of all the equations that
12 are in the model and a brief explanation of
13 how they are put together. The impacts are
14 in other documents.

15 Q. Oh, that's the other document that
16 was published -- posted on the Internet?
17 This is the model that you used to derive --

18 A. The summary of it was in the hearing
19 announcement.

20 Q. Yes.

21 A. And there are some more detailed

1 tables that --

2 Q. I got it. I got it. Now, I
3 understand the function of this Exhibit 28.

4 All right. I don't have any more
5 questions about Exhibit 28, but I may need to
6 take another look at the analysis that was
7 published. Thank you.

8 THE JUDGE: Other questions?

9 Mr. Miltner?

10 EXAMINATION

11 BY MR. MILTNER:

12 Q. Ryan Miltner on behalf of Select Milk
13 Producers, Continental Dairy Products and
14 Dairy Producers of New Mexico.

15 Dr. McDowell, I have a quick question
16 on Exhibit 28, the only question I have on
17 that exhibit for the moment.

18 A. Which one is 28 now?

19 Q. The econometric baseline model. And
20 I'm looking at page 5, Table 2, and the
21 footnote there, in particular. It says,

1 "For years when the Milk Income Loss
2 Contract program is in operation, the
3 average MILC payment is added to the all milk
4 price."

5 Is that a historical note or, in your
6 model, does that forecast into the future at
7 all?

8 A. It does not forecast in the future
9 with this model because the MILC program was
10 slated to go out of existence prior or after
11 -- I think the date was December 1st. But
12 certainly after 2005, it was supposed to go
13 away. So they are included historically,
14 but not into future with respect to
15 this particular model and this baseline.

16 Q. Okay. So the forecasts that are in
17 the appendix to your preliminary analysis
18 and in the preliminary analysis that's
19 contained in the hearing notice, the all
20 milk prices that are reported in that
21 analysis do not include any MILC payments

1 before --

2 A. That is correct.

3 Q. Okay.

4 I guess I have one other question on
5 Exhibit 28. Just so I can clarify in my own
6 head and follow up on what Mr. Vetne had
7 asked, exhibit 28 is a summary of how your
8 econometric model works, is that correct?

9 A. That is correct.

10 Q. There is nothing in Exhibit 28
11 itself that describes the actual impacts of
12 any of the scenarios listed in the proposed
13 rule?

14 A. That is correct.

15 Q. Okay.

16 Moving to what I think is Exhibit 2,
17 which is the appendix to the preliminary
18 analysis, I'll start with page 2, Table A-2.
19 Can you describe for us what this table is
20 meant to portray?

21 A. Yes. First of all, we have three

1 different scenarios that we started off
2 with. This particular table relates to
3 Scenario 1. Okay?

4 Q. And that's the same Scenario 1 -- I
5 don't mean to interrupt, but the same
6 Scenario 1 that's on page 547 of the Federal
7 Register Notice?

8 A. That is correct. In the Federal
9 Register, we published, in the tables there,
10 six-year averages. I understand that should
11 have been five-year averages. I think there
12 is an errata statement that's somewhere.

13 Q. The beginning of Exhibit 2?

14 A. Right. And so, what this appendix
15 is intended to do is to provide the
16 year-by-year results that were reported in
17 the summary tables in the Federal Register.

18 Q. So if we start at the top of Table
19 A-2, what this is showing for -- where it
20 says 2005-06, that's for the federal
21 government fiscal year '06, so October 1 '05

1 through September 30, '06, correct?

2 A. [The witness nodded.]

3 Q. You are going to have to say yes or
4 no.

5 A. Yes. I'm sorry.

6 Q. That's okay. She can't take down
7 the nod so well.

8 A. Yes. Thank you.

9 Q. That's okay. So in the first -- in
10 fiscal year '06, the first column, you are
11 expecting, according to your model, that the
12 Class I price of 3-1/2 percent butterfat to
13 fall 16 cents a hundredweight?

14 A. That is correct.

15 Q. And that continues across. So the
16 following year, you are expecting a 2 cent
17 reduction from the baseline, not from the
18 previous year, correct?

19 A. That is correct.

20 Q. And then that proceeds through all
21 the classes. And then three lines from the

1 bottom, where you are showing a negative
2 impact of 8 cents a hundredweight on the all
3 milk price at test --

4 A. Where do you see that again?

5 Q. I'm looking at the column that's
6 '05-06, and all the way down at the bottom.
7 This is the third line from the bottom.

8 A. I'm with you.

9 Q. Okay. All milk price at test minus
10 8 cents a hundred. Can you explain exactly
11 what that 8 cents is a reduction from and
12 what the all milk price consists of for this
13 table?

14 A. Okay. In terms of what it is being
15 reduced from, if you look on Table A-1, the
16 preceding page, the corresponding baseline
17 price for '05-06 is 14.75. Okay. So it is
18 an 8 cent reduction from that.

19 Okay, now, as I understand the
20 question, what you would like for me to do
21 is to relate the decline in the Class III

1 and IV prices and then come all the way down
2 through this table to the bottom line, 8
3 cent reduction in the all milk price.

4 Q. Well, I guess initially what I
5 wanted you to state for us is, what is the
6 all milk price on this table?

7 A. The all milk price on this table is
8 -- is an attempt -- our attempt at
9 estimating the NASS reported all milk price.

10 Q. So that would include -- the all
11 milk price includes over-order premiums?

12 A. Correct.

13 Q. If there were a milk payment,
14 historically, would that have been included
15 in the all milk price and the MILC payment?

16 A. I'm not sure how -- I'm not sure how
17 that's handled at NASS.

18 Q. Okay. Let me just see if I can
19 summarize. The all milk price represents --
20 is that equivalent to a mailbox for all
21 producers?

1 A. No, it is not. I would refer you
2 back to Mr. Rourke's testimony this morning.
3 The NASS all milk price is an FOP plant
4 price. It is the price that plants are
5 paying for milk delivered to the plants.

6 Q. Okay.

7 A. The mailbox price includes other
8 types of payments such as was referred to
9 this morning as thirteenth check. And I
10 forgot the other term, but -- dividend from
11 cooperatives. Thank you.

12 Q. It is also different from the
13 Federal order blend price which you have
14 listed about a third of the way down the
15 page?

16 A. That is correct.

17 Q. And Table A-2, you are forecasting a
18 blend price reduction of 13 cents a hundred?

19 A. That is correct.

20 Q. Did you have a chance to look at or
21 review what I believe is marked Exhibit 13?

1 That was information that I had requested
2 from my clients from the various Market
3 Administrator's offices.

4 A. I am familiar with it. I haven't
5 looked at it.

6 Q. I believe I brought a copy up here.

7 THE JUDGE: No. 13 was Mr. Rourke's
8 statement.

9 MR. MILTNER: Attached to it is a
10 number of charts which were admitted with
11 this statement.

12 BY MR. MILTNER:

13 Q. I'll gave you my copy of Exhibit 13
14 and I'll work off my notes here. If you can
15 turn to what is marked as page 7 to that, I
16 think that's the first table summarizing
17 blend price or recalculation of the pool. I
18 think that's probably Order 1.

19 A. I have it.

20 Q. If you look in the column that's
21 labeled Scenario 1, for 2004 and 2005 they

1 show a difference in the blend price or
2 statistical uniform price of 36 cents a
3 hundredweight. And on your Table A-2, you
4 have blend price impact of 13 cents a
5 hundredweight. And I realize this is just
6 Order 1. I'm sorry, that's 26 cents a
7 hundredweight. And I think the range, if
8 you look at the other orders, is 23 to 26
9 cents under Scenario 1.

10 How do you account for the difference
11 between what the Market Administrators have
12 calculated the impact on the pool to your
13 calculation of impact on the price?

14 A. The -- what the Market
15 Administrators have done is to go back -- my
16 understanding is that they have gone back
17 and recalculated the -- all the class prices
18 and the uniform price, given the different
19 make allowances that they were given to work
20 with, and compared that against what
21 historical fact was. And in so doing, I

1 believe it is the case that they held
2 constant the butter, nonfat dry milk, the
3 cheese, the dry whey prices, the NASS prices
4 that are used in formulas.

5 Somebody might tell me whether that's
6 correct or not.

7 Q. I can't tell you whether that is
8 correct or not.

9 A. I believe that's correct. Well,
10 what our analysis does -- let me add, I
11 think that what they have done is accurate.
12 I think that's -- I have no reason to
13 question these numbers.

14 In our analysis that we have done
15 with the econometric model, on the very page
16 that Mr. Vetne was referring to is where the
17 all milk price is generated. And if you --
18 we think that the -- we estimate that the
19 all milk price will fall with a reduction in
20 the blend price.

21 But the other factors that are

1 involved in that all milk price estimation
2 are the NASS prices for dairy products,
3 namely, cheese, butter, nonfat dry milk, dry
4 whey. Well, the all milk price falls, we
5 start getting a supply response. As less
6 milk is being produced, the dairy product
7 prices go back up a little bit.

8 In fact, if you look in the table
9 there, the product prices, cheese goes up by
10 -- in this scenario, cheese goes up by a
11 penny and a quarter; butter, a little over 3
12 cents; and so on and so forth. So that is
13 the moderating effect that's taking place in
14 the market as a result of less milk being
15 produced. You carry that on out further, and
16 that's why the results attenuate year by
17 year as we go through.

18 Q. Did -- when you plugged in these
19 make allowance changes into your model, what
20 month did you begin with? In other words,
21 when did you anticipate the rules would

1 change and the make allowance calculations
2 would change?

3 A. FY05-06, I -- I'm not sure. I'm not
4 sure when we did that. Hang on just a
5 second. Let me refer to what we did here.

6 Q. Sure. Take your time.

7 A. May I have permission to ask one of
8 my colleagues exactly when we started with
9 that?

10 Q. I have no problem with that at all.

11 [Whereupon, the witness conferred
12 with a colleague.]

13 THE WITNESS: Okay. That's what I
14 thought. We began it in October of '05. So
15 we began it with the beginning of that
16 fiscal year 05-06.

17 BY MR. MILTNER:

18 Q. Okay. So you are assuming, then,
19 that the rules have already taken effect?

20 A. We -- first of all, we did this for
21 illustrative purposes, and we had to begin

1 sometime.

2 Q. I understand.

3 A. And instead of breaking up a year,
4 we didn't know exactly when the rules would
5 take effect, so we began with the fiscal
6 year.

7 Q. Okay. But in the model, October 1,
8 2005, make allowances change, and then you
9 ran your model under those assumptions --

10 A. Right.

11 Q. -- under those formulas going
12 forward?

13 A. That is correct.

14 Q. Okay. So may I ask, then, the blend
15 price difference from baseline, the all milk
16 price difference from baseline reported for
17 fiscal year 05-06, is that figure for the
18 blend price for the final month of that
19 year, or is that a blend price and all milk
20 price for the average of that year?

21 A. Average cost that year. This is an

1 annual model.

2 Q. And it takes the average for that
3 annual period?

4 A. That is correct.

5 Q. Under your model, how quickly are
6 the changes in supply, how quickly does the
7 market respond to those changes in price,
8 and how is supply affected as a function of
9 the milk price, the class price?

10 A. There is a very small change in the
11 first year, then there is a lag effect. If
12 I may refer you to page 5 of the
13 documentation exhibit --

14 Q. Would that be --

15 A. Line documentation.

16 Q. Okay. Go ahead.

17 A. You see, when we estimate milk
18 supply, we have -- we estimate the number of
19 milk cows, and we also estimate the milk per
20 cow. And in both of these equations, there
21 is a significant lag component. So we get

1 an initial effect in the first year, and then
2 we get a bigger effect that takes place the
3 following year.

4 Q. By looking at the numbers here in
5 Table 2, can you tell us what that lag is in
6 terms of days or percentages of the year?

7 A. Everything on here is in terms of
8 annual average.

9 Q. Okay.

10 A. And so, milk cows, first thing --
11 the first thing that determines whatever the
12 number of cows is, it's 97 percent of the
13 last year. That's down in about the fourth
14 variable.

15 Q. Okay. Lag, parenthesis, milk cows?

16 A. Right. And so, you get the initial
17 shot on the milk price, and then you -- then
18 it carries through, because it's -- you get
19 the first shock, and then it's -- it carries
20 through because next year is 96 percent of
21 this year. So it carries through until a

1 point when it dissipates out. After about
2 three or four years, it is over.

3 Q. So for -- October of 2005 is T-1 or
4 T-0?

5 A. Right.

6 Q. Is the number of milk cows at T-0 97
7 percent of the number of milk cows at T-1?

8 A. 98 percent.

9 Q. Okay. So you are assuming two
10 percent of cows are instantly culled? Is
11 that --

12 A. No, plus these other factors.

13 Q. Okay.

14 A. And it is not October 1st. This is
15 an annual model, so it is the average across
16 2005-2006.

17 Q. If we had -- I guess so I can
18 understand, if you add a hundred cows in the
19 country on October 1, 2005, or let's say
20 September 30th, 2005, how many cows would be
21 in your model on October 1?

1 A. This is an annual model. The number
2 of cows that are in the model for FY05 is
3 the average number of cows as reported by
4 NASS for '05.

5 Q. Okay.

6 A. And so, there is going to be
7 deviations around that average in most
8 months. And the same goes for '06. So this
9 is an annual model.

10 Q. Okay.

11 A. So if we can talk about it in terms
12 of the annual averages, when we go from one
13 year to the next, 2006, the number of milk
14 cows is going to be about 97 percent of what
15 last year's was, '05. And then, in addition
16 to that, you can multiply the all milk price
17 by this other estimated parameter that's 75,
18 okay, and that adds a few cows.

19 And then there is also a feed price
20 variable in there with a negative sign on
21 it. So as feed prices go up, number of cows

1 goes down. And similarly with slaughter
2 price. As the slaughter price goes up, the
3 number of cows goes down.

4 And then there are a couple of
5 additional factors in there that are
6 correcting for the buyout program and some
7 other factors that we can't estimate.

8 Q. So I guess to ask the question a
9 different way, is the impact of the change
10 in the make -- the change to the make
11 allowance, is the increase in make
12 allowances reflected in a fewer number of
13 cows beginning with fiscal year '06?

14 A. We didn't report the number of cows
15 in here, but that is correct. We have both
16 Federal order marketings and United States
17 marketings going down, and that would be
18 with regard to both fewer cows and lower
19 milk per cow.

20 Q. You run up the other factor in
21 decreased production, which is less milk

1 produced per cow.

2 Can you explain to us how your model
3 takes that into account and, also, if you
4 could again, the lag in timing of that
5 change.

6 A. It's a very similar -- a very
7 similar equation. Milk per cow is highly
8 related to what it was the year before. And
9 it is positively related to the milk feed
10 price ratio. So milk per cow is
11 approximately 98 percent of last year's,
12 previous year's milk per cow. And then that
13 gets adjusted by the milk feed price ratio.
14 As milk price goes up, milk per cow would go
15 up. As feed price goes up, milk per cow
16 would go down.

17 Q. So assuming that you held feed
18 prices and milk prices constant, you would
19 assume that, on an annual basis, we would
20 produce 98 percent of the milk per cow that
21 we produced the year prior?

1 A. And add to that the intercept, which
2 is a positive number. So we would expect it
3 to usually grow.

4 Q. Okay. Have you had chance to test
5 your model against actual producer reactions
6 to increased prices or decreased prices and
7 see if the lag is reflective of actual
8 on-farm decisions regarding cull rates and
9 breeding rates and feeding and production
10 decisions?

11 A. To the extent that all those
12 decisions are reflected in the NASS
13 collection of data, the answer is yes. We
14 do not have any sample of data on farms
15 except as it comes through NASS. And so --
16 so the answer is yes as it comes through us
17 in official USDA data.

18 And I might add that probably among
19 our equations that we strive to estimate,
20 the fit is probably as good here as you'll
21 find anywhere else. So we are explaining

1 almost all of the variation through the
2 sample that we have with these equations.

3 THE JUDGE: Mr. Miltner, how much
4 longer do you think you are going to go?

5 MR. MILTNER: Maybe 10 or 15 minutes
6 at the most. If you want to take a break,
7 Judge, that's fine.

8 THE JUDGE: I was thinking we were
9 maybe at appropriate time to take a break.
10 That also might give you a chance to sharpen
11 up your remaining questions.

12 MR. MILTNER: If I could ask one
13 follow-up on this issue before we take our
14 break.

15 THE JUDGE: All right.

16 BY MR. MILTNER:

17 Q. Is it correct, then, your last
18 answer that your model takes NASS data and
19 then all of these numbers, your intercepts
20 and your coefficients, I suppose, are the
21 result of the multiple regression analysis?

1 A. That is correct.

2 Q. So the only input you have is the
3 various NASS data and the other factors, and
4 then you run your multiple regression to
5 develop your model?

6 A. That is right. And we -- well, you
7 may imply this, but we run a lot of
8 different equations to come up with what
9 seems to be the best.

10 MR. MILTNER: Okay. We can take a
11 break.

12 THE JUDGE: Let's take 15 minutes at
13 this time, and let's be back by, oh, 22
14 after.

15 [Whereupon, the hearing
16 recessed at 3:06 p.m. and reconvened at 3:21
17 p.m.]

18 THE JUDGE: Dr. McDowell, you are
19 still under oath.

20 MR. MILTNER: Thank you, Your Honor.

21 BY MR. MILTNER:

1 Q. Dr. McDowell, before the break, we
2 were talking about the decreases in milk
3 supply, and we identified two sources of
4 milk supply reductions: reductions in the
5 number of cows and the reductions in the
6 amount of milk produced by cows.

7 Do you have any estimates based on
8 your model of the actual number of cows that
9 the national herd would be reduced by and
10 the average marketings per capita it would
11 be decreased?

12 A. We didn't report that data, but we
13 have it, and I can get it. I don't have it
14 off the top of my head, but we can get that.

15 Q. If you could find that and produce
16 it for us, that will be appreciated.

17 A. Okay.

18 Q. In that data, if you look at just
19 the number of cows that are going to be
20 lost, do you have any breakdown between the
21 number of cows that will be removed from farms

1 that will still be in existence versus the
2 number of whole herds that will be retired
3 by farmers?

4 A. No, we do not. Strictly the number
5 of cows.

6 Q. You would agree that, in all
7 likelihood, a number of cows will be reduced
8 by farmers who decide to go out of business
9 as a result of low prices?

10 A. I think that likely would be the
11 case.

12 Q. Do you have any way with your model
13 to predict the number of farms that will go
14 out of business as a result of low prices?

15 A. No, I do not, but I agree that --
16 that a portion of cows will leave.

17 Q. Do you have any guess or any
18 estimate as to the impact of these changes
19 region by region or order by order or a
20 geographic basis?

21 A. Not at this time, but cow responses

1 are different, and I believe there are
2 certain reasons that they are more
3 responsive to price changes than others. I
4 don't have that information right now before
5 me.

6 Q. Is that something you can produce?

7 A. I can get the response, but I can't
8 make the calculations very quickly.

9 Q. If you were to produce that kind of
10 information, would you be able to ascribe to
11 the different regions the number of cows
12 that would be culled in those regions?

13 A. I don't think so. I have got some
14 rough estimates, but I don't have it
15 calibrated to the point right now to be able
16 to do that. That would be the kind of thing
17 that we would expect to do in a full-blown
18 analysis, not a preliminary analysis.

19 Q. Would you be performing a full-blown
20 analysis at some point before a rule change
21 to take effect?

1 A. Yes.

2 Q. In your position with AMS, do you
3 study any of the impacts of price increases
4 and decreases on the farms of varying sizes?

5 A. No.

6 Q. Do you have any opinion based on
7 your model or other work you have done as to
8 how this change may or may not affect a
9 large farm versus a small farm?

10 A. I am currently not aware of any
11 recent study that has been done that
12 differentiates between supply or among
13 supply responses across -- across sizes.

14 However, I think the -- what I read
15 and sort of hear around is that perhaps the
16 very largest farms are less responsive to
17 smaller price changes, and perhaps there are
18 some very small farms that can absorb price
19 changes, but maybe there are some that are in
20 the middle range that are between management
21 regimes that may have a more difficult time

1 with it.

2 But that's -- that's reading and
3 hearing and no definitive studies that I'm
4 aware of.

5 Q. In the hearing notice, it states
6 that the marketings under the federal
7 program account for 61 percent of all milk
8 used for manufacturing, so 39 percent of
9 milk outside the Federal order system.

10 Do you anticipate that these changes
11 will have an effect on the prices received
12 by producers who ship their milk to those
13 non-Federal order manufacturing prices?

14 A. Yes, sir, I do. As a matter of
15 fact, in our analysis, we show that one of
16 the impacts is that the manufactured dairy
17 product price, its NASS product prices will
18 increase. And so, therefore, if you are
19 selling milk that's mainly for cheese, for
20 example, it would have a positive effect on
21 it.

1 Q. I asked about the regional impact of
2 the changes on the production and the
3 changes in production. Does your model
4 forecast the price changes or mailbox prices
5 or all milk prices on an order-by-order
6 basis or geographic basis?

7 A. No, sir, it does not. But with the
8 changes in the Class III and Class IV
9 prices, the entire price structure is going
10 to be moving up and down pretty much the
11 same across the board. Milk markets are
12 national in scope and the adjustments that
13 take place are regional. But ultimately, it
14 is national, and all these markets are tied
15 together.

16 The question that you asked would
17 have a different answer if we were dealing
18 with a Class I differential, for example, in
19 one region. But when we are talking about
20 the entire price structure moving up and
21 down, it would be an a-cross-the-board kind

1 of effect.

2 Q. It would also be different if, for
3 instance, we decoupled Class I prices from
4 Class III and IV prices and didn't change to
5 make allowances for Class I and II?

6 A. That would be a different scenario.

7 Q. If such a scenario were proposed,
8 would your office be able to provide us with
9 an analysis under those scenarios?

10 A. Yes.

11 Q. Using numbers in my head and not off
12 of any report, would you agree that there
13 are roughly, give or take 10 billion pounds,
14 about a hundred billion pounds of milk
15 marketed through the federal system?

16 A. Well, let's see.

17 Q. It's in there somewhere.

18 A. I'm not a numbers guy. Let's see.

19 Q. I heard from Mr. Beshore 120
20 million.

21 A. That looks about right to me.

1 Q. Okay. So if we use Table A-2 and
2 the blend price falls, I want to say 13
3 cents, and the blend price falls 13 cents a
4 hundredweight, that is 130 million less 26.
5 So \$156 million, roughly, it would amass,
6 right? Or you are not a numbers guy?

7 A. Well, it is pretty right, because if
8 you look right there in terms of Federal
9 order cash receipts, the total change that
10 we calculated is \$155 million.

11 Q. And that's real money, right, out of
12 producers' pockets?

13 A. That would be money that's in the
14 pool.

15 Q. It is no longer in the pool, and
16 that money that's in the pool gets paid back
17 to producers, correct?

18 A. That's a portion of what is paid to
19 producers.

20 Q. Where else would the producer get
21 the income that's not in the pool?

1 A. Well, there are over-order payments
2 that are made which can be additional funds
3 and -- excuse me just a second.

4 Q. Sure.

5 A. I want to check something here for
6 this answer. If you look on Table A-1. The
7 baseline, in this case, 2005 and 2006, the
8 Federal order minimum prices test were
9 estimated to be 14.72. And at the national
10 level, the all milk price at test were
11 14.75. So they are close, without question.

12 Q. And actually, I just noticed this
13 last line on Table A-2 is U.S. producer
14 revenue showing loss of \$258 million. So
15 that is \$158 million that producers are not
16 going to receive under Scenario 1?

17 A. That is correct.

18 Q. And under Scenario 2, it is \$243
19 million that they lose?

20 A. In the first year.

21 Q. That's just the first year?

1 A. In the first year.

2 Q. And \$318 million in Scenario 3?

3 A. That's what we estimate, yes, sir.

4 Q. And that's just for that year. And
5 your model shows that there are mitigating
6 impacts but still losses every year for all
7 producers throughout, is that correct, and
8 that's -- that takes into account all their
9 income and that takes into account
10 over-order premiums, the all milk price. It
11 takes into account all those items as money
12 producers will never get back?

13 A. [The witness nodded.]

14 MR. MILTNER: Can you just state your
15 answer?

16 THE WITNESS: Sorry. Yes, that is
17 correct.

18 BY MR. MILTNER:

19 Q. So even your model, and it is a
20 model that is run one hundred percent
21 accurate, we are talking, over time,

1 potentially billions of dollars taken away
2 from producers that they cannot recover?

3 A. Well, tables are showing hundreds of
4 millions.

5 Q. Each year?

6 A. Less than that in subsequent years.
7 So I don't come up with billion in what we
8 have got here.

9 Q. Let's come up with a billion. Then
10 Table A-4, if I look at the very bottom
11 right corner, average impact to revenue of --

12 A. That would wind up being a billion,
13 yes.

14 Q. And that continues to apparently
15 2010 on at \$148 million year?

16 A. No, sir, it would be declining.

17 Q. By a billion dollars because it is
18 149 a year, so maybe some very slight --

19 A. It would be declining.

20 Q. And just so we are fair and
21 equitable, even under the lower the more

1 modest cut, under Table A-2, we are still
2 looking at \$72 million a year, on average,
3 and \$50 million a year in lost revenues and
4 actually increasing, is it not?

5 A. Say that again.

6 Q. If you look at Table A-2 and you
7 look at producer revenues, the average for
8 your model period is \$72 million in losses
9 per year, and in that scenario, we are
10 actually seeing increased losses every year
11 over the last three years? But the bottom
12 line is, under any of the scenarios, we are
13 looking at hundreds of millions, if not
14 billions, of dollars that's going to be lost
15 --

16 A. In these particular scenarios, that
17 is correct.

18 MR. MILTNER: Thank you. I don't
19 have any other questions.

20 THE WITNESS: I have some
21 clarification that I would like to make. You

1 were asking me a while ago concerning the
2 monthly changes that were calculated with
3 respect to blend prices and classified prices
4 by the order.

5 MR. MILTNER: Yes.

6 THE WITNESS: I want to talk about
7 that vis-a-vis what we are doing with these
8 annual numbers. There are two ways to come
9 up with annual numbers. One is to have
10 monthly calculations that are made and
11 monthly models. And if that were the case,
12 if we had a monthly model, then our first
13 month would be similar to the kind of
14 changes that were calculated by the order
15 offices.

16 What we have to work with are annual
17 numbers that are annual averages when we
18 start off with them. So a lot of the monthly
19 variation that is taking place all the time
20 is already taken out of the data. So there
21 is really no difference in terms of concept

1 here except that we are starting off with
2 annual average numbers to begin with.

3 And I might add that when we do
4 policy analysis, we are bound to do it
5 against the USDA baseline, which is
6 constructed with these kinds of annual
7 averages. So that -- I wanted to put a
8 little bit more context on that to make sure
9 that there is no substantive dispute between
10 what we are doing here and those numbers.
11 Ours just happen to be annual averages to
12 begin with.

13 BY MR. MILTNER:

14 Q. In other words, your annual model is
15 -- that is the data you have --

16 A. That's right.

17 Q. -- available to you? And you
18 suggest that's actually what you're required
19 to do because the baseline is an annual
20 figure?

21 A. That is correct.

1 Q. And so, in using annual figures, you
2 lose a lot of the contours and seasonal
3 changes that would otherwise show up?

4 A. That is correct. And that's why
5 your question about the cows in terms of the
6 end of September and the next day, it
7 doesn't -- it doesn't compute with what we
8 have to work with. We have to work with
9 annual averages to begin with.

10 Q. Thank you. I appreciate that
11 clarification. Thank you.

12 A. Okay.

13 THE JUDGE: Other questions? Mr.
14 Vetne.

15 EXAMINATION

16 BY MR. VETNE:

17 Q. I believe you were asked the
18 question or maybe simply affirmed a
19 statement to the effect that your model
20 shows losses for all producers every year.
21 Do you recall --

1 A. Yes, I do recall that discussion.

2 Q. To the extent that some producers
3 now are taking their milk to a cooperative
4 manufacturing plant and, when the commodity
5 dairy product is produced, they are not
6 recovering the costs of making that product
7 in the market price but, nevertheless, have
8 to account to the pool at a price that is
9 higher than the value of the milk, that
10 group of producers, if they had to account
11 for the pool, at the value of milk
12 reflecting a make allowance as to that
13 recovery of costs, that group of producers
14 would gain because they would no longer be
15 subsidizing other producers in the pool,
16 correct?

17 A. Well, I don't -- I don't know that I
18 follow where the subsidy came from.

19 Q. Well, let's see. If -- on a
20 hundredweight basis, right? If the Class
21 III price is \$14 but 50 cents of that \$14

1 represents manufacturing costs that cannot
2 be recovered, not by virtue of the
3 marketplace, but by virtue of regulation --
4 you have a quizzical look. Let me start
5 being even more basic.

6 I'm not going to use actual numbers
7 here. I'm just going to use easy numbers for
8 easy repartee. The price of 10 pounds of
9 cheese from a hundred pounds of milk that
10 can be recovered is \$15. Okay, 10 pounds of
11 cheese sells \$1.50 a pound is \$15 recovery
12 gross from the sale of the commodity. The
13 Federal order allows a dollar to be
14 recovered, 10 cents per pound for cheese.
15 So the Class III price, then, is \$14. Are
16 you with me so far?

17 A. [The witness nodded.]

18 Q. The actual cost to make that cheese
19 is \$1.50, not a dollar, a dollar fifty per
20 10 pounds. Are you still with me?

21 A. Yes.

1 Q. A cooperative manufacturer operating
2 in the Federal order system must account to
3 the pool for milk going into that cheese at
4 \$14. All of the producers in the pool,
5 whether they make that cheese or not, get
6 the benefit of that \$14 that the cooperative
7 has accounted to the pool for milk going
8 into that cheese, correct?

9 A. Well, they -- all the producers in
10 the pool share in the revenue.

11 Q. Share in the -- that \$14 is pooled
12 money, correct?

13 A. [The witness nodded.]

14 Q. And all the producers share in that
15 \$14 from the revenue of that sale of milk to
16 that cheese. But the cooperative making that
17 cheese, it's costing them a dollar fifty, not
18 a dollar. That cooperative, by 50 cents, is
19 not recovering its costs, and by 50 cents is
20 subsidizing other producers in the market.
21 That's what I meant by subsidy.

1 Would not those producers -- and the
2 question, getting back to the original one,
3 would not those producers be a group of
4 producers that would fare better if they were
5 able to recover their costs and were not
6 forced by regulations to subsidize the whole
7 pool?

8 A. I'm not going to address your
9 statement about the subsidy.

10 Q. All right. Address it any way you
11 want.

12 A. The way the order works is that the
13 returns from the order are shared while
14 producers are pool in the order.

15 Q. The classified prices are shared?

16 A. That is right.

17 Q. Right.

18 A. And this hearing is trying to derive
19 at the appropriate level of what the make
20 allowances are by -- in your hypothetical,
21 if the organization is losing money on the

1 plant, then it has a decision to make. But
2 it is also the case that the -- the returns
3 to the producers in the organization are not
4 coming from just Class III, they are coming
5 from the entire pool.

6 So I don't know what else to say, but
7 I'm not going to address the subsidy portion
8 of it.

9 Q. Okay. I won't ask you to adopt that
10 word.

11 I agree with you, the system is
12 supposed to share the returns on the sale of
13 milk. In my hypothetical, the cost to
14 produce cheese is 50 cents greater than
15 allowed in the regulated price formula.

16 Are you able to agree that the return
17 to producers on the sale of milk into cheese
18 is not uniformly shared in that cooperative
19 making of it, is suffering less return for
20 that milk than yield producers?

21 A. No, I'm not going to agree to that.

1 The cooperative that's making the cheese
2 could be involved in a variety of
3 cheese-making activities. There was
4 discussion earlier today about the fact that
5 there is different cheeses being manufactured
6 and sold on the market. And based on these
7 kinds of numbers, there is not enough in the
8 story here to know whether the cooperative
9 is making money or not.

10 Q. As a system-wide basis is really
11 what you are saying, that many
12 organizations, including cooperatives, have
13 a number of business endeavors? They sell
14 milk to bottlers. They make cottage cheese.
15 They age cheese. They put jalapenos in and
16 make it really sharp and good. All those
17 things produce revenue. That's what your
18 answer is.

19 You do not dispute that the NASS
20 survey price for commodity cheese represents
21 an actual sale price for a whole bunch of

1 cheese, do you?

2 A. No, I don't dispute that.

3 Q. And you don't dispute that, when the
4 Federal order fixes a minimum Class III
5 price, that that's the price that has to be
6 paid for milk going into that cheese?

7 A. For cheese manufacturers that choose
8 to pool that milk.

9 Q. In the Federal order, yes. I'm
10 talking about Federal order milk.

11 A. Manufacturers are not bound to be in
12 the Federal order. But if they choose to be
13 in the order, then that is the minimum price
14 that's required to be paid.

15 Q. Minimum price?

16 A. That's the accounting to the pool.

17 Q. That's the accounting to the pool.

18 Now, in producing your model -- let
19 me see if I remember. The all milk price
20 reported by NASS includes or does not
21 include revenue to producers before the

1 producer has to pay for transportation?

2 A. My understanding of the all milk
3 price is that it is an FOB plant price,
4 which means that the milk is delivered to
5 the plant. So that's the price that the
6 plant's paying at the door.

7 Q. Oh, okay. So it does not include
8 income before transportation. I think the
9 same thing was described as a mailbox price
10 earlier. You are not sure about it?

11 A. I think the mailbox price, as we
12 spoke earlier, includes monies such as
13 thirteenth checks and cooperative dividends,
14 and I think it's net of hauling. But you
15 would have to check with Mr. Rourke's
16 testimony for sure about that.

17 Q. We can check the record.

18 To the extent -- well, let's try
19 this. If manufacturing plants consistently
20 do not recover from the commodity market the
21 cost of producing product, like producers

1 who don't recover the cost of production,
2 they tend to close, go out of business. Do
3 you agree with that?

4 A. [The witness nodded.]

5 THE JUDGE: That was a yes.

6 THE WITNESS: Yes.

7 MR. VETNE: Thank you.

8 THE WITNESS: I would say yes unless
9 there is some other purpose for keeping that
10 plant open.

11 BY MR. VETNE:

12 Q. You are aware that plants -- there
13 is a lot of things that go into business
14 decisions.

15 A. That is correct.

16 Q. But you are aware that, over the
17 years, the number of plants has dwindled
18 just as the number of producers has
19 dwindled?

20 A. That is correct.

21 Q. Is there any component of the models

1 that you -- projections that you produced
2 that factors in the additional cost to dairy
3 farmers in future years if, as a result of
4 nonrecovery of costs, a plant that is there
5 today is no longer there tomorrow and the
6 producer has to haul his milk an extra 2 or 3
7 or 500 miles?

8 A. I do not account for that in the
9 models.

10 Q. Does the model essentially assume
11 that all the outlets that are there now will
12 be there in the future?

13 A. No, there is no assumption
14 whatsoever. What we have done with the
15 model is to statistically estimate the
16 effect on prices of, in this case, changes
17 in the make allowance.

18 Now, the way that affects the lots of
19 organizations is far beyond my ability to --
20 to take into account. I wouldn't attempt
21 it. But there is no question that when you

1 change something like that, that it will
2 affect organizations differently, and the
3 producers in the organization will be
4 affected.

5 Q. Or producers who are in a part of an
6 organization?

7 A. There is no question. There are
8 effects that we don't purport to understand.

9 Q. So if I understand correctly the all
10 milk price that you captured in your model
11 from NASS, which is an FOB plant price, would
12 not capture increased costs to producers,
13 transportation costs, primarily, from doing
14 nothing?

15 A. That is correct. It doesn't account
16 for that.

17 MR. VETNE: Thank you.

18 THE JUDGE: Mr. Wellington.

19 EXAMINATION

20 BY MR. WELLINGTON:

21 Q. Bob Wellington, Agri-Mark. I

1 just have a few questions referring to the
2 appendix of the preliminary analysis. I'm
3 not sure what exhibit number that was.

4 But on Table A-1 of that, which is
5 your baseline table, I'm referring to the
6 bottom of baseline table, where you have U.S.
7 marketings?

8 A. Yes, sir.

9 Q. If you look at from the 2005-2006,
10 the first year of your analysis, to the last
11 year of your analysis, was showing that milk
12 production is growing about 10 billion pounds
13 per year during that period, total growth of
14 10 billion pounds. Do you agree with that?

15 A. Well, I see the growth going across
16 there. It goes from 175.8 billion to 179.1
17 billion, etc.

18 Q. Right.

19 A. Okay.

20 Q. If we were to then look at your
21 Table A-4, which is the Scenario 3, the

1 maximum impact scenario that you looked at,
2 and we were to look at the average impact on
3 U.S. marketings, over the five-year period,
4 it shows minus 327 million pounds, correct?

5 A. Yes.

6 Q. So if I were to accumulate that over
7 the five-year period, it would basically be
8 five times that average?

9 A. Correct.

10 Q. Or approximately 1.6 billion pounds.

11 So if the baseline was up 10 billion
12 pounds, and then depresses the baseline by
13 about 1.6 billion pounds during that time
14 period, milk production is still up even,
15 with the impact of Scenario 3, by
16 approximately 8.4 billion pounds. Even under
17 Scenario 3, the milk supply is growing.
18 That's what I'm trying to get at.

19 A. That's what we show there.

20 Q. That's what the model would show.

21 And then, in addition, on that table

1 A-4, you -- the total impact over five years
2 accumulates to over \$1 billion. That was
3 the question I was asking you earlier.

4 A. Say that again.

5 Q. On Table A-4, the average impact on
6 U.S. producer revenues was \$207 million per
7 year?

8 A. Times the five.

9 Q. Times the five is roughly about a
10 billion dollars?

11 A. Correct.

12 Q. But if you were to calculate that on
13 a per- pound-of-milk basis or a
14 hundredweight-of-milk basis, you really have
15 to divide that by the total amount of milk
16 produced over that five-year period because
17 this is a five-year cumulative impact.

18 A. I don't know what you want to do
19 with it, but let me explain what we have
20 here.

21 Q. Sure.

1 A. Again, we have got annual numbers,
2 and we have changes from the annual
3 baseline. This averages out at the -- in
4 the final column of this column is just
5 simply taking those five numbers in the row
6 and dividing them by five. It's a simple
7 average of those annual numbers.

8 Q. Right.

9 A. That's what this is.

10 Q. But what I'm saying is, the billion
11 dollar number, that was a cumulative number
12 over a five-year period?

13 A. Yes.

14 Q. So I was just saying that in order
15 to get the average impact per volume of milk,
16 you have to divide that by the cumulative
17 milk production during that five-year
18 period?

19 A. One could do that.

20 Q. One could to do that?

21 A. One could do that.

1 Q. That's fine. Thank you.

2 THE JUDGE: Other questions? Mr.

3 Beshore.

4 EXAMINATION

5 BY MR. BESHORE:

6 Q. Marvin Beshore. Just one question,
7 Dr. McDowell. In the hundred-million-dollar
8 litmus test for this type of study that you
9 refer to, is that per year, over five years,
10 Federal order marketings, national impact,
11 or how do you determine that?

12 A. I believe that that executive order
13 -- and perhaps our counsel can help us with
14 the title of it, but I believe it refers to
15 a hundred million dollars per year.

16 Q. And for a rule of this type, would
17 that apply to impact within Federal order
18 marketings or nationally, do you know?

19 A. I believe it is national, but I'm --
20 I'm not the one to interpret the very
21 specifics of that executive order. We

1 generally think that we were getting close
2 to that number, so we provided the analysis.

3 Q. In this case, you thought you might
4 be close. That's why you did the analysis?

5 A. Yes.

6 Q. Thank you.

7 THE JUDGE: Other questions?

8 Dr. McDowell, you were asked to
9 estimate the impact of increasing the make
10 allowance. Your testimony here today was --
11 it is not in favor or against any of the
12 proposals being considered at this area?

13 THE WITNESS: That is correct.

14 THE JUDGE: Your testimony is part of
15 your duties here as an employee of the
16 United States Department of Agriculture?

17 THE WITNESS: That is correct. I
18 think it may be useful for us to explain how
19 we came up with these scenarios. The
20 proposal refers to changing the make
21 allowances as calculated by Charles Ling. We

1 didn't have that information available to us,
2 so we looked to California. And we thought
3 that a logical thing to do would be to see
4 what the changes in the manufacturing cost
5 reported by California, what that change was
6 from 1994 to 2004.

7 So that's how we started out, and I
8 think that's referred to in the hearing
9 proposal. And if you'll look there, the
10 change in cheese was very small. Well, the
11 context of the proposal was perhaps cheese
12 manufacturing costs had gone up
13 significantly. So that's why we did what we
14 did with the cheese make allowance.

15 With regard to whey, we didn't have
16 any history like that for whey, so we
17 arbitrarily chose a 10 percent. And it was
18 simply to have a set of scenarios that would
19 illustrate the effects of increase in these
20 make allowances. But we have no idea --
21 when we did this, we had no idea what the

1 numbers would be, and we have no position at
2 this point.

3 THE JUDGE: Other questions? Mr.
4 Yale.

5 EXAMINATION

6 BY MR. YALE:

7 Q By the way, I want to thank you for
8 having this study. This gives a context to
9 look at this a lot different than what we
10 have been able to do in the past. Maybe you
11 aren't a numbers guy, but the numbers are
12 informative.

13 I have a question that I wasn't sure
14 was fully clarified. And that is, in your
15 econometric model, you do have provision for
16 this buyout and milk diversion. It shows up
17 in the model. Can you explain why it is
18 there and what impact that has on this
19 model?

20 A. Yes. The first thing is that we
21 have to be consistent with USDA baseline.

1 So we want to take into account programs and
2 policies that affect the number of cows in
3 milk production. And with regard to the
4 past, we have had some equations in there to
5 try to estimate some of it. But it's very
6 difficult, as you know, because of the
7 nature of the program. It has size
8 implications, regional implications and so
9 on.

10 But the fact is, in the baseline, we
11 have other people that help us in this
12 process, in the USDA process, that are more
13 closely associated with that program. And
14 so, the baseline incorporates that
15 information.

16 So it is in there, and we account for
17 it. But we don't generate any estimates of
18 that in the past. It just so happens for
19 this particular baseline, it was ending, so
20 it's not in the future.

21 Now, for the next baseline, we will

1 have to address it more than we have this
2 time because the MILC program is back, it
3 appears.

4 Q. So you keep it in the program for a
5 number of years after the program ends. You
6 don't -- holder buyout ended, what, 20 years
7 ago, approximately?

8 A. Right.

9 Q. And the conversion program was prior
10 to that?

11 A. Right. And it is necessary for us
12 to have it in our -- now I think the I
13 understand the question better. We have to
14 account for these kinds of events in our
15 estimating procedures because they are
16 events that have taken place. So when we go
17 back and look at data from, say, 1980 and
18 estimate something, we have to account for
19 the fact that these additional events that
20 take place with regard to the market are
21 properly accounted for.

1 Q. And because your model doesn't look
2 at anything back to 1980, it really has no
3 impact on the end result of your conclusions
4 that you provide?

5 A. That is correct. It helps us better
6 fit the equations for the things that we are
7 interested in, namely, price.

8 Q. Okay. Thank you.

9 A. You are welcome.

10 Q. That's all I had.

11 THE JUDGE: Other questions?

12 Dr. McDowell, it looks like you may
13 step down. Thank you.

14 MS. DESKINS: We have no further
15 witnesses at this time. We will, however,
16 recall some people for which requests were
17 made as soon as they are able to fulfill
18 those requests.

19 THE JUDGE: Very well. It's a little
20 after 4:00. Mr. Vetne, do you want to start
21 or do you want

1 MR. VETNE: Oh, I think we'll start.

2 Mr. Wellington is ready to present his
3 statement, and most people have received
4 their copy.

5 THE JUDGE: While you are passing
6 copies out, I have been asked to remind the
7 people in the audience that the court
8 reporter does need four copies of any
9 statements which are being put into the
10 record.

11 [Whereupon, the witness was
12 duly sworn by the judge.]

13 THE JUDGE: Please be seated, tell us
14 your name and spell your last name for the
15 hearing reporter.
16 Whereupon,

17 ROBERT D. WELLINGTON,
18 called on behalf of Agri-Mark, having been
19 first sworn by the judge, was examined and
20 testified under oath as follows.

21 THE WITNESS: My name Robert D.

1 Wellington. That's spelled

2 W-E-L-L-I-N-G-T-O-N.

3 THE JUDGE: Very well, Mr.

4 Wellington. Your statement has been marked
5 as Exhibit 29. Do any of the tables need to
6 be separately marked or can I refer to them
7 -- do you want two rather than one exhibit?

8 THE WITNESS: I'll defer to my
9 counsel on that.

10 THE JUDGE: Do you want a cumulative
11 exhibit?

12 MR. VETNE: Your Honor, I think it
13 would be good to have one and then have the
14 tables be A,B, C, D.

15 THE JUDGE: Very well.

16 MR. VETNE: And I would like to --

17 THE JUDGE: Actually, the tables are
18 numbered.

19 MR. VETNE: Oh, they are numbered.
20 Yes, let me say that this document was
21 handed out earlier. Most people received a

1 copy. For some reason, many of the copies
2 did not a page 2. Hopefully, those that did
3 not have a page 2 now received one. If you
4 don't have a page 2, there are a few extra up
5 here.

6 THE JUDGE: And it also appears that
7 Table 9 is --

8 MR. VETNE: There was a Table 9 that
9 should have been attached that wasn't.
10 Let's just pretend it is attached, is that
11 all right --

12 THE WITNESS: That's fine.

13 MR. VETNE: -- as part of the
14 exhibit.

15 EXAMINATION

16 BY MR. VETNE:

17 Q. Mr. Wellington, you provide your
18 curriculum vitae in your prepared testimony,
19 is that right?

20 A. Yes.

21 Q. Who you are and what you have done.

1 And you testified many times at Federal
2 order hearings and state order hearings and
3 regional hearings and so forth?

4 A. Yes, I have.

5 Q. Okay. Proceed with your testimony,
6 please.

7 STATEMENT FOR THE RECORD OF ROBERT WELLINGTON

8 My name is Robert D. Wellington. I
9 serve as Senior Vice President of Economics,
10 Communications and Legislative Affairs for
11 Agri-Mark Dairy Cooperative. I have served
12 in that capacity, along with being their
13 economist, since 1989.

14 Prior to that I worked eleven years
15 as an economist and the chief of research and
16 market information with the former New York -
17 New Jersey Milk Market Administrator's
18 Office. I have a Bachelor's and a Master's
19 degrees in agricultural economics from
20 Rutgers University, where I also taught.

21 Agri-Mark is a Capper-Volstead

1 Cooperative with approximately 1300
2 member-owners whose farms produce milk
3 throughout the six New England States and New
4 York State. Agri-Mark owns and operates a
5 cheese plant in Middlebury, Vermont, another
6 in Chateaugay, New York, a cheese and other
7 dairy products plant in Cabot, Vermont and a
8 butter-powder plant in West Springfield,
9 Massachusetts.

10 Proposal #1 was submitted by
11 Agri-Mark in order to address a very serious
12 crisis faced by its member-owners and its
13 operations as well as the operations of all
14 dairy product manufacturers who use Class III
15 and IV milk pooled under Federal Milk
16 Marketing Order.

17 BACKGROUND:

18 Current Class III and IV Federal
19 order prices are determined using end-product
20 pricing formulas. Such formulas begin with a
21 national survey of the price of the primary

1 end-products which use Class III and Class IV
2 milk. The survey is conducted weekly by NASS
3 using pricing information from many plants
4 which manufacture commodity cheddar cheese,
5 butter, nonfat dry milk and whey powder. A
6 monthly weighted average price is determined
7 for each of the four products. The ruling
8 commodity prices are then adjusted by fixed
9 manufacturing allowances and yield factors to
10 determine final Class III and IV milk and
11 component prices to be paid under the Federal
12 order. The manufacturing allowance is the
13 amount of milk allowed in each pricing
14 formula in order to manufacture each type of
15 product. The class prices produced after
16 manufacturing allowances are subtracted from
17 dairy commodity prices are the imputed values
18 of raw producer milk for each manufacturing
19 use.

20 Monthly commodity prices used in the
21 Class III and IV formulas vary each month

1 according to the actual selling prices of the
2 cheese, butter, nonfat dry milk and whey
3 powder. When any of these prices change, the
4 prices of milk and milk components paid by
5 manufacturers also change. However, under
6 current Class III and Class IV price
7 formulas, the make allowance is fixed and
8 does not change no matter how manufacturing
9 costs change unless a Federal order hearing,
10 USDA decision and favorable producer
11 referendum occurs.

12 Manufacturing allowances that are
13 fixed in the class pricing formulas bear no
14 relationship with the selling prices of any
15 of the dairy products mentioned or the prices
16 received by farmers for their milk. If
17 cheese, butter, nonfat dry milk, NFDM, and
18 whey powder prices were to double tomorrow,
19 Class III and IV prices and farm prices would
20 more than double, but manufacturing plants
21 would receive the exactly same allowance. In

1 fact, manufacturing costs for energy,
2 insurance, labor, capital and/or any other
3 input could double; yet the manufacturer
4 would not get one penny more to cover those
5 costs under the existing order provisions.

6 THE SITUATION:

7 The costs of manufacturing dairy
8 products have risen dramatically since the
9 time period when the order manufacturing
10 allowances were last surveyed. Current order
11 provisions use costs from cooperative plants
12 from primarily 1998 as well as California
13 plant survey costs from 1999 as reported in
14 February 2000. Energy costs in particular
15 have more than doubled, but other costs such
16 as employee medical programs, insurance
17 premiums and packaging have increased
18 dramatically as well.

19 The manufacturing costs have risen to
20 such a degree that dairy commodity
21 manufacturing plants that purchase Federal

1 order Class III and IV milk are losing
2 substantial amounts of money. A number of
3 manufacturing plants in the Northeast milk
4 marketing area where Agri-Mark members farm
5 have ceased production recently and class
6 pricing problems have played a role in these
7 closings.

8 During the past two years, a number
9 of Class III manufacturing plants have closed
10 or substantially reduced their cheese
11 production. These plants include a Kraft
12 cheddar cheese plant in Canton, New York, a
13 Sorrento Italian cheese plant in Goshen, New
14 York and a Saputo cheese plant in Allentown,
15 Pennsylvania. Each of those three plants
16 formerly received upwards of 30 million
17 pounds of producer milk per month. Just last
18 fall, the Lucille Farms Italian cheese plant
19 in Swanton, Vermont closed its doors, citing
20 the distorted Federal order Class III prices
21 as a major reason for their recent financial

1 hardships. That plant regularly received
2 about 15 to 20 million pounds of milk per
3 month.

4 A fifth cheese plant operated by
5 Suprema Cheese in Ogdensburg, New York that
6 received about 20 million pounds of milk per
7 month closed in 2004. The plant was recently
8 reopened by a kosher cheese maker. That
9 plant now receives only one million pounds of
10 kosher producer milk per month. A Losurdo
11 Italian cheese plant in Heuvelton, New York
12 recently down-sized from 20 million pounds
13 per month to 10 million pounds per month.

14 These six plants combined no longer
15 use almost 140 million pounds of producer
16 milk per month or about 1.7 billion pounds of
17 producer milk per year. That is the
18 equivalent of the milk production of more
19 than 1000 Northeast dairy farms.

20 Table 1 shows the monthly Class III,
21 Class IV and total producer receipt milk

1 volumes for the Northeast Federal order in
2 2005. Also shown are the monthly milk
3 volumes as a percentage on the average annual
4 monthly volume. Class III usage ranges from
5 a high of 107 percent of the average volume
6 in May to a low of 92 percent of the average
7 in October. Class IV usage ranged from a
8 high of 145 percent in May to a low of 48
9 percent in September. Clearly, both Class
10 III and Class IV prices seasonally balance
11 producer milk supplies. Class IV plants do
12 this to the greatest degree.

13 Table 2 shows the Class III, Class IV
14 and total producer receipt milk volumes for
15 the Northeast Federal order on an annual
16 basis from 2001 through 2005. Class III and
17 IV usage as a percentage of total producer
18 receipts are also calculated. Current Class
19 III usage of milk has fallen 2.3 billion
20 pounds from the 2001/2002 period. While much
21 of this lost manufacturing milk volume

1 originated from the Northeast plants which
2 closed or down-sized, it also shows that
3 remaining Class III plants are using less
4 producer milk. Class III utilization has
5 fallen from 31.4 in 2001 to 22.9 in 2005.

6 Milk production and total Northeast
7 order producer receipts fell in 2003 and
8 2004. Class IV butter and nonfat dry milk
9 plants again performed a balancing role and
10 used less milk in both years. However, when
11 milk production rose in 2005, the remaining
12 cheese plants in the region absorbed
13 relatively little of the extra milk, while
14 butter/powder plants absorbed most of it.
15 Class IV utilization rose from 8.8 percent in
16 2003 to 9.7 percent in 2003 and then to 12.7
17 percent in 2005. These Class IV plants took
18 in the extra milk to clear the markets of
19 surplus milk, not because it was profitable
20 to do so. It is not surprising that that
21 all the remaining large Class IV plants in

1 the Northeast are operated by cooperatives.

2 Federal order Class III and IV plants
3 perform important roles in Federal orders.
4 They balance Class I and II needs seasonally
5 and on weekends and holidays, as well as
6 provide nearly regular orderly markets for
7 producers in the Federal order marketing
8 areas. Proprietary plants that purchase
9 Federal order milk must pay the Federal order
10 minimum prices. Competitive pressures as
11 well as fairness issues necessitate that
12 cooperative plants do likewise or else risk
13 losing members and milk supplies.

14 In industries not subject to
15 government price regulations, increased costs
16 may be passed on and recovered by buyers.
17 Even in the regulated dairy industry, Class I
18 and Class II processors may pass on costs
19 without limits imposed by USDA. However,
20 this is not possible for dairy commodity
21 manufacturers operating under Federal milk

1 order pricing. Any attempts to raise
2 commodity prices and apply that additional
3 sales revenue to cover the higher
4 manufacturing costs have been disallowed by
5 USDA. In 2005 international demand for
6 nonfat dry milk powder was rising as were the
7 costs of energy to make the product. Dairy
8 America, a federation of cooperatives,
9 including Agri-Mark, that jointly market
10 about 80 percent of the U.S. nonfat dry milk
11 production, was able to adjust its selling
12 price and accounted for the increase as an
13 energy surcharge. Their hope was to exclude
14 this energy surcharge from the NASS price
15 survey. NASS did not allow a separate
16 surcharge and instead raised the NASS survey
17 price. That higher price was subsequently
18 used in the Class IV price calculation and
19 raised the milk price paid by Federal order
20 nonfat dry milk manufacturers accordingly.
21 Despite higher energy costs, manufacturers

1 received no additional money to cover those
2 costs.

3 Manufacturing allowances used under
4 the Federal order are intended to cover the
5 cost of making the products. Cheese, butter,
6 nonfat dry milk and whey powder prices used
7 in the formulas are updated monthly,
8 resulting in new class prices. Agri-Mark
9 believes that manufacturing allowances must
10 also be updated to reflect current reality.

11 The impact of current Federal Milk
12 Market order manufacturing allowances on
13 Agri-Mark plant operations for our fiscal
14 year 2004, which goes from December 1, 2003
15 to November 30, 2004, are shown in Table 3.
16 This table uses the product volumes and costs
17 that are reported in the 2004 RBCS report as
18 well as our actual return on investment,
19 administrative costs and marketing costs
20 which will be discussed in greater detail
21 further in my testimony. Agri-Mark operates

1 whey condensing equipment at its Cabot plant
2 and whey separation and condensing equipment
3 as is Chateaugay plant. Whey in various
4 forms is shipped from those plants to our
5 full whey processing facility that is part of
6 our Middlebury cheese operation. The
7 Agri-Mark Middlebury plant does not produce
8 commodity whey powder but instead produces
9 whey protein concentrate and permeate,
10 lactose powder. I have estimated the pounds
11 of whey powder equivalent from the pounds of
12 cheese produced at each plant based upon a
13 ratio of 0.6 pounds of whey powder for each
14 pound of cheese produced. Our costs of
15 making whey protein concentrate and permeate
16 are much higher than that for whey powder and
17 the final prices are different, so it would
18 not be appropriate to use our actual costs.
19 Instead, I used the costs being proposed
20 based upon the RBCS and CDFA surveys and
21 combined in the same fashion USDA used in

1 their last decision.

2 The total impact of Agri-Mark
3 incurring its manufacturing costs while only
4 receiving the equivalent of the current order
5 manufacturing allowances is a negative \$15.4
6 million in 2004. This represents a cost
7 difference of 65 cents per hundredweight on
8 all of the milk produced by our
9 member-owners. Agri-Mark members have, in
10 fact and effect, subsidized the Northeast
11 blend price by accounting to the pool for
12 much more than the value of milk used to make
13 Class III and Class IV commodity products.
14 The amount of this unfair subsidy has grown
15 steadily as manufacturing costs have risen
16 for seven years, but the manufacturing
17 allowance has not changed. The inequity is
18 now of crisis proportions.

19 Due to this cost crisis facing
20 Agri-Mark and all Federal order dairy
21 manufacturers, Agri-Mark and others in

1 notification industry are seeking the fastest
2 and simplest manufacturing allowance update
3 that can be done in a fair and reasonable
4 manner. We believe that the fairest way, and
5 hopefully the quickest, is to update the
6 order manufacturing allowances by duplicating
7 the surveys and methods already accepted by
8 USDA that have already been used in the past
9 to determine make allowances. We all have
10 various concerns relative to several other
11 Class III and Class IV pricing provisions,
12 but we have laid aside those concerns
13 temporarily in order to address this crisis.
14 Once this crisis has been addressed,
15 Agri-Mark is very supportive of having a
16 hearing conducted - having a second hearing
17 conducted and more comprehensive Class III
18 and Class IV pricing hearings as soon as the
19 Dairy Division of USDA deems appropriate in
20 order to deal with those.
21 OTHER ISSUES.

1 We also believe that a full,
2 nationwide manufacturing cost survey
3 methodology should be developed and then
4 conducted annually to regularly update make
5 allowances and prices. Cornell University is
6 developing such a methodology and survey.
7 Agri-Mark operations and financial staff are
8 assisting Cornell in this endeavor. When the
9 survey is complete and reviewed by the
10 industry, we believe that is when a more
11 comprehensive hearing should be held.

12 PROPOSAL #1.

13 In order to provide the necessary
14 information for an emergency cost update
15 hearing, Agri-Mark asked the Rural Business
16 Cooperative Service, RBCS, now known as the
17 Cooperative Service, to update the survey
18 that they have conducted in the past. Dr.
19 Charles Ling has done so and we appreciate
20 his efforts. The California Department of
21 Food and Agriculture also conducts an annual

1 survey of plant costs which is usually
2 released in the fall. We also appreciate
3 their willingness to testify about their
4 survey at this hearing.

5 Table 4 shows the calculations of the
6 new make allowances being proposed by
7 Agri-Mark under Proposal #1. It uses the
8 weighted average of the largest RBCS and
9 California manufacturing cost surveys for
10 40-pound block cheddar cheese and butter.

11 CHEESE:

12 In order to determine the cheese
13 manufacturing allowance, we are proposing
14 using the weighted average costs of the RBCS
15 40-pound block cheddar plants and all the
16 California cheddar cheese plants. Relative
17 to the California survey, this is the same
18 group as used by USDA in the last decision
19 setting current allowances. The RBCS survey
20 had sufficient plants this time to report
21 costs separately for plants which produced

1 40-pound blocks of cheddar cheese. Although
2 cheese costs from additional plants were also
3 available in the RBCS survey results, that
4 larger group also included plants that
5 produced cheddar cheese in 640- and 500-pound
6 containers and some other types of cheese, as
7 well as the 40-pound block plants. The
8 weighted average costs of the larger group,
9 inclusive of the 40-pound block group, was
10 \$0.18 cents below that of the 40-pound block
11 only group. We believe that the price
12 difference was caused by the lower costs of
13 producing barrel cheese. In fact, when the
14 40-pound block group is removed from the
15 larger group, the remaining plants in that
16 larger group are shown to have a cost of
17 production of \$0.1211. This is 3.0 cents
18 below the 40-pound block group. In the
19 current order pricing provisions, USDA
20 already adds exactly 3.0 cents to the NASS
21 barrel cheese price to bring that price to a

1 40-pound block level. This makes it clear
2 that USDA already accounts for the lower
3 costs of producing barrel cheese in this
4 formula and therefore only the 40-pound block
5 cheddar cheese manufacturing costs should be
6 included when setting manufacturing
7 allowances for cheese.

8 In addition, the CDFA cheese cost
9 manufacturing survey has adjusted plant costs
10 since 1996 to standardize their reported
11 costs to a 40-pound block plant basis.

12 Please see footnote 1 of the CDFA summary
13 table entitled "Weighted Average
14 Manufacturing Costs for Butter, Nonfat
15 Powder, Skim Whey Powder and Cheddar Cheese,
16 the 1989-2005 amended January 2006." This is
17 exhibit -- I don't know the number offhand --
18 already discussed by the CDFA representative.

19 THE JUDGE: It's 23 as supplemented
20 by 24 and 25.

21 MR. WELLINGTON: Thank you. Exhibit

1 23?

2 BUTTER:

3 In the decision establishing the
4 current make allowance for butter, USDA
5 combined the RBCS weighted averages for all
6 plants in that survey with the weighted
7 average of only the high cost butter plants
8 in the CDFA survey. The Department's
9 reasoning for using only the high cost
10 subgroup for California was to reflect
11 similar plant sizes as those in the RBCS
12 survey, along with reflecting the balancing
13 role that such plants perform in the Federal
14 order system.

15 As we reviewed the RBCS and
16 California plant size data for 2004 shown in
17 Table 5, we saw that the low costs butter
18 group averaged 72 million pounds of
19 production annually and the high cost group
20 averaged 234 million pounds. The simple
21 average of both groups was 48 million pounds.

1 The RBCS plants produced 36 million pounds of
2 butter per year but had a capacity to produce
3 more if not for their balancing role. Had
4 there been sufficient plants to report a
5 California medium cost group, we likely would
6 have preferred that option, but it was not
7 available. Under the circumstances, we felt
8 it was fairer and more appropriate to use the
9 entire weighted average of all CDFA butter
10 plants in calculating a proposed make
11 allowance, even though that method results in
12 a smaller make allowance than the method used
13 by the USDA in the last decision.

14 NONFAT DRY MILK:

15 The make allowance for nonfat dry
16 milk determined in the last decision also
17 used the entire RBCS weighted average for all
18 plants but then only used the weighted
19 average of the two lower cost subgroups, of
20 three total groups, from the CDFA survey. As
21 shown in Table 5, the RBCS nonfat dry milk

1 plants produced an average of 31 million
2 pounds of product annually, although like
3 with butter, they performed a balancing role.
4 This compares with 156 million pounds for the
5 low cost California group, 60 million pounds
6 for the medium cost group and 13 million for
7 the high cost group. If you combined the low
8 and medium cost group, the average production
9 would still be 101 million pounds per plant.
10 We propose that USDA use only the medium cost
11 group from California. We believe that this
12 is the most appropriate cost group when
13 considering comparable plant sizes. We do
14 not believe it is appropriate to use the
15 weighted average of all three subgroups
16 because the three low cost plants produce so
17 much powder that they dramatically distort
18 the average costs of the seven other plans.
19 In addition, the sheer volume of the nonfat
20 dry milk production indicated that it is
21 unlikely that they perform a balancing role

1 similar to the RBCS Federal order plans.

2 It is important that USDA understands
3 the limitations of weighted averages when
4 determining a cost. An average cost weighted
5 by the product volume implies that half the
6 product volumes in the group will have higher
7 costs and half lower costs. Those with
8 higher costs than a fixed manufacturing
9 allowance will not be able to cover their
10 costs and will lose money on that part of
11 their operation. However, when there is a
12 wide range of plant sizes involved in a cost
13 survey and those much larger plants tend to
14 have lower than average costs, using a
15 weighted average leads to not just half the
16 product volumes not being able to cover their
17 costs it also leads to the majority of plants
18 not being able to cover their costs. When
19 the huge plants more often happen to be in
20 California and the smaller ones are in the
21 Federal orders, a weighted average cost can

1 lead to the majority of plants in the Federal
2 orders not being able to cover their costs.
3 I do not believe that would be the intention
4 of the Department, particularly relative to
5 nonfat dry milk plants which balance Class I
6 markets.

7 It is also important to recognize
8 that the recent building of extremely large
9 dairy product manufacturing plants out west
10 will likely result in lowering the weighted
11 average manufacturing costs. However, all
12 else being equal, when such a large low cost
13 plant opens its doors and the national
14 weighted average cost appear to fall as a
15 result, the actual cost incurred by the
16 remaining plants in the country have, indeed,
17 not changed. For USDA to reflect such a
18 change in manufacturing cost allowances would
19 likely hurt most other plants in the country.

20 WHEY POWDER:

21 We propose that the whey make

1 allowance be determined by adding a
2 differential cost per pound to the NFDM
3 manufacturing allowance as discussed above.
4 This is the same method USDA used in the last
5 decision when a cost factor of \$.019 per
6 pound was added to the nonfat dry milk make
7 allowance. I understand that others will be
8 providing testimony to show that the updated
9 cost factor is \$.025 due to higher energy
10 costs and perhaps other factors. For my
11 analysis purposes, I will show the price
12 impacts of using either a \$.019 or a \$.025
13 additional cost. Based on the evidence and
14 testimony at this hearing, we believe that
15 USDA should use the appropriate fixed cost,
16 whether it be \$.019 or \$.025 and add it to
17 the nonfat dry milk make allowance to set the
18 whey power manufacturing costs.

19 In that last decision, whey powder
20 plant cost data was not available. For this
21 decision, we had hoped that approximately

1 plant cost data would assist the Department
2 in setting the appropriate make allowance.
3 However, we are concerned about the
4 widespread difference between the RBCS and
5 CDFA survey costs and some of the cost
6 components in the RBCS survey. In addition,
7 whey is handled in many different ways at
8 cheese plants, depending upon the size of the
9 operation, its proximity to alternative
10 outlets for its whey and even the age of the
11 plant. Some cheese plants even dispose of
12 their whey by land spreading or feeding to
13 cows or pigs. Agri- Mark's plant in
14 Chateaugay, New York currently land spreads
15 some of its whey component products because
16 our whey-processing facility in Middlebury,
17 Vermont cannot handle all the whey from our
18 three facilities. On occasion, we and others
19 in the Northeast sell condensed whey to
20 Canada and other areas. Our concern with
21 whey is that if the Federal order pricing

1 formulas continue to assign a high value to
2 the Class III price based upon the
3 manufacturing of whey at very large, new
4 plants that costs tens of millions of dollars
5 to build, smaller and older plants like many
6 in the Northwest will be at a large
7 competitive disadvantage under minimum
8 Federal order pricing. If whey pricing
9 issues force a company to build a whey drying
10 facility that often costs far more than its
11 cheese plant, that company may just close its
12 doors or relocate entirely to the milk
13 surplus western states. That just happened
14 this fall with a cheese plant in Swanton,
15 Vermont.

16 California has been collecting whey
17 cost data for two years now, but even their
18 price setting authority did not recognize
19 their own survey data and methodology as
20 appropriate to set the state's actual make
21 allowances. During both of those years, the

1 survey has reported a cost of \$.267 per
2 pound, but their rate setting authority used
3 only \$.20 per pound for the past year as the
4 appropriate make allowance. The RBCS data
5 generates similar concerns. It reports
6 dramatically lower costs than in California,
7 a full ten cents per pound lower when all
8 comparable costs are added. In addition, the
9 RBCS survey reported energy costs for whey
10 powder which are 35 percent lower per product
11 pound than for nonfat dry milk. This makes
12 little sense since whey begins with a higher
13 moisture content than nonfat dry milk and
14 requires an additional processing step. I am
15 not an expert in this area, but Mr. Richard
16 Langworthy, who is in charge of all of our
17 manufacturing operations, including our whey
18 processing facility attached to our
19 Middlebury, Vermont plant can speak further
20 to this issue during his testimony. In
21 addition, I believe that other knowledgeable

1 witnesses will also be giving testimony later
2 in the hearing.

3 Dr. Ling has conducted his cost
4 survey many, many times for cheese, butter
5 and nonfat dry milk. This has allowed him
6 and survey participants to thoroughly review
7 the methodology for these products. This is
8 only the second time that Dr. Ling has
9 attempted to calculate whey powder production
10 costs. Problems in the allocation of costs
11 as well as the reporting of all costs may
12 have played a role. In addition, I
13 understand that the economies of scale
14 achieved by the RBCS survey plants at near,
15 or surprisingly above 100 percent capacity,
16 are only achieved through the transportation
17 of condensed whey from other facilities.
18 These transportation costs need to be
19 accounted for if the Department wishes to
20 make use of the RBCS and DCFA data. In
21 addition, any plant operating so close, or

1 above, full capacity on an annual basis in
2 markets that do have not have production
3 seasonality -- I'm sorry, that do have
4 production seasonality must have times of the
5 year when their whey cannot be processed in
6 their full plants. The Department must also
7 somehow account for those costs.

8 Indeed, most plants producing
9 American cheese, such as cheddar, do not
10 process whey into powder or other dry whey
11 products as disclosed in USDA's publication
12 "Dairy Plants Accepted and Approved for
13 Grading." Of the 83 American cheese plants
14 listed for 2005, 46 plants do not dry whey or
15 whey products. Neither do the hundreds of
16 smaller plants who must find ways to dispose
17 of their whey by- product. This situation
18 should counsel caution as the Department
19 looks to assign manufacturing allowances that
20 will likely overstate the Class III price for
21 most cheese makers.

1 The industry needs a quick decision
2 on updating manufacturing allowances, as
3 quick as possible to update manufacturing
4 allowances as possible. Clearly, the
5 methodology of whey cost accounting needs
6 more work. In fact, this is an area where
7 the Cornell manufacturing cost study can
8 address more thoroughly at the next hearing
9 hopefully held within a year or so. In the
10 meantime, we support updating the nonfat dry
11 milk manufacturing allowance and adding the
12 appropriate cost differential of either \$.019
13 or \$.025 to it in order to set the whey make
14 allowance by the same approach as in USDA's
15 last decision.

16 RETURN OF INVESTMENT, ADMINISTRATIVE AND
17 MARKETING COSTS:

18 Agri-Mark's proposal includes
19 updating the return on investment as well as
20 administrative and marketing costs in the
21 same manner used in the last decision

1 regarding manufacturing allowances. That
2 decision made use of the California costs for
3 the appropriate group categories reported in
4 the CDFA survey. Table 6 shows the 2004
5 California costs along with the Agri-Mark
6 costs at our Middlebury, Vermont and West
7 Springfield, Massachusetts plant facilities.

8 Agri-Mark costs are above the
9 California costs for every category except
10 administrative costs for our Middlebury
11 cheese plant. Our Middlebury plant is
12 relatively new and very labor efficient which
13 may be the reason why our allocated
14 administrative costs are lower. In addition,
15 we believe that the California costs are
16 sufficiently representative at this point to
17 be used again.

18 IMPACT OF 2004 SURVEY ALLOWANCES ON
19 CLASS AND COMPONENT:

20 Table 7 shows a summary of the 2004
21 survey manufacturing allowances that are part

1 of our proposal. The cheese manufacturing
2 allowance increases from \$.65 to \$.179 per
3 pound. The butter manufacturing allowance
4 increases from \$.115 per pound to \$.151 per
5 pound. The nonfat dry milk make allowance
6 rises from \$.14 to \$.187 per pound. The whey
7 powder manufacturing allowance rises from
8 \$.159 to \$.206 when a \$.019 factor is added
9 to the nonfat dry milk price and to \$.212
10 when a \$.025 is added.

11 The price of butterfat falls \$0.044
12 -- should be cents per pound. The price of
13 protein remains unchanged and the price of
14 nonfat solids fall \$.0.46 cents per pound.
15 The price of other solids falls from \$.048 to
16 \$0.54 per pound depending upon the additional
17 nonfat dry milk factor.

18 Class III prices fall from \$.43
19 solids to \$.46 solids per hundredweight, once
20 again, depending upon the nonfat dry milk
21 factor used. The Class IV price falls \$.55

1 per hundredweight.

2 IMPACT OF 2004 SURVEY ALLOWANCES

3 ON AGRI-MARK OPERATIONS:

4 The impact of Proposal #1 upon

5 Agri-Mark operations can be seen in Table 8.

6 This table is the same as Table 3 from the

7 beginning of my testimony. However, in this

8 table the manufacturing cost allowances have

9 been changed from the current ones to the

10 2004 survey allowances. These reviewed make

11 allowance reduce our cost shortfalls by \$7.2

12 million or approximately \$600,000 per month.

13 This represents \$0.30 per hundredweight on

14 our annual member milk volume.

15 Keep in mind that these 2004 make

16 allowances do not make our operations break

17 even. The allowances were designed to be

18 conservative and used weighted averages that

19 tend to disadvantage smaller plants like

20 ours. In addition, as noted earlier, the

21 impacts shown in Table 8 make it appear that

1 our whey operations would now break even.

2 That is likely not the case, but my use of
3 the 2004 whey powder make allowances as a
4 proxy for actual costs resulted in the break
5 even status of whey powder.

6 ADJUSTING MANUFACTURING ALLOWANCES TO
7 INCLUDE 2005 ENERGY COSTS:

8 It is a lengthy process to gather and
9 organize cost data. The costs shown in the
10 two surveys use primarily 2004 information
11 since 2005 data is not yet available this
12 early in 2006. In the case of Agri-Mark, the
13 cost time period we used was our fiscal year,
14 which was December 2003 to November 2004.
15 General costs during 2005 have only gone up
16 slightly in most areas with the notable
17 exception of energy and energy-related costs.
18 Energy costs, particularly for fuel oil,
19 natural gas and propane have jumped
20 substantially.

21 Richard Langworthy, Agri-Mark's

1 Senior Vice President of Manufacturing
2 Operations will be testifying on Agri-Mark
3 specific energy and other costs later in this
4 hearing. His information will show the huge
5 increases in energy costs that have occurred
6 just in the past few years. These high rates
7 are also reflected in our anticipated energy
8 costs for 2006.

9 On January 10, 2006, the U.S.
10 Department of Energy released its short-term
11 energy outlook and discussed its energy cost
12 price projections for West Texas Intermediate
13 Crude Oil, Gasoline and Crude Oil prices and
14 Natural Gas Henry Hub Spot Prices. The crude
15 oil price averaged \$41.44 per barrel in 2004,
16 which was a 33 percent increase from 2003.
17 In 2005, that price jumped another 36 percent
18 to \$56.47 on average. According to the U.S.
19 Department of Energy, that price is expected
20 to average \$63 in 2006 and \$60 in 2007. In
21 2006 and 2007 oil prices are expected to be

1 52 percent and 45 percent respectively above
2 2004 price levels.

3 Natural gas prices, Henry Hub Spot,
4 averaged \$6.20 per thousand cubic feet in
5 2004 and rose 45 percent in 2005 to \$9.00 per
6 thousand cubic feet. 2006 and 2007 prices
7 are expected to be \$9.80 and \$8.84
8 respectively or increases of 58 percent and
9 43 respectively above 2004 prices.

10 Clearly, energy prices are increased
11 substantially in 2005 and expected to remain
12 significantly above 2004 levels through 2007.
13 It is crucial that the Federal order
14 manufacturing allowances incorporate at least
15 2005 energy price changes.

16 We have worked with others in the
17 industry to find a very simple set of energy
18 indices that can fairly and reasonably update
19 2004 energy costs to reflect 2005 levels. We
20 propose that the energy adjustments for 2005
21 be calculated using the Producer Price

1 Indexes for Industrial Natural Gas, BLS
2 series WPU0553, and the Industrial Electric
3 Power Distribution, BLS Series WPU0543, Base
4 equals 1982, weighted by the costs per pound
5 of product in the RBCS survey as well as the
6 CDFA survey, if those individual prices are
7 entered into the hearing record.

8 These Producer Price indices show a 6
9 percent annual average increase in electric
10 power costs and a 23.8 percent increase in
11 Industrial Natural Gas costs from 2004 to
12 2005. I have applied those percentage
13 changes toward the appropriate costs per
14 pound for each product under the RBCS costs
15 only since California energy costs are not
16 available yet.

17 The bottom rows of Table 4 shows that
18 as a result of this energy adjuster, the
19 cheese manufacturing allowances would be
20 increased by \$.0021 per pound, the butter
21 allowance would increase by \$.0028 per pound

1 and the nonfat dry milk allowance would rise
2 by \$.0098 per pound.

3 We understand that the National Milk
4 Producers Federation will be proposing an
5 ongoing energy index to adjust the
6 manufacturing allowances on a continuing
7 basis. Their proposal uses the same Producer
8 price indices as we used in our 2005
9 adjustment. While we support the National
10 Milk Producers Federation proposal, we, as
11 well as National Milk Producers Federation,
12 all recognize the ongoing energy adjustor is
13 a new concept for settling manufacturing
14 allowances. There is concern that the
15 National Milk Producers Federation proposal
16 may take more time and review for the
17 Department to consider than Agri-Mark's
18 relatively simply and straightforward update
19 of current manufacturing allowances. We
20 believe that the Department should therefore
21 issue an interim emergency decision relative

1 to Agri-Mark's proposal using 2004 RBCS and
2 CDFA survey data adjusted for 2005 energy
3 costs and then provide a more thorough
4 comment and review period before issuing a
5 decision for the ongoing adjustor proposed by
6 National Milk Producers Federation.

7 IMPACT OF PROPOSED MANUFACTURING ALLOWANCES
8 ON CLASS AND COMPONENT PRICES:

9 The manufacturing allowances proposed
10 by Agri-Mark include a moderate 2005 energy
11 adjustor. Those allowances are also shown in
12 Table 7. The impact of the energy adjustor
13 is approximately a quarter of a cent per
14 pound for cheese and butter and one cent per
15 pound for nonfat dry milk and whey powder.

16 The proposed manufacturing allowances
17 are \$0.181 for cheese, \$0.154 for butter,
18 \$0.197 for nonfat dry milk and either \$0.216
19 or \$0.222 for whey powder. The butter fat
20 price falls \$0.047 per pound, the protein
21 price falls \$0.003 per pound and the nonfat

1 dry milk price falls \$0.056 per pound. The
2 other solids price falls either \$0.058 per
3 pound or \$0.064 per pound. The Class III
4 price falls either \$0.51 or \$0.54 per
5 hundredweight while the Class IV price falls
6 \$0.65 per hundredweight.

7 IMPACT OF PROPOSED MANUFACTURING ALLOWANCES
8 ON DAIRY FARMER PRICES:

9 There is no way to avoid Proposal #1
10 having a negative impact on producer blend
11 prices announced under the Federal orders.
12 This has been a great concern to Agri-Mark as
13 our cooperative is owned and controlled by
14 its dairy farmer members. In the past,
15 Agri-Mark has played significant roles in
16 successful efforts to increase dairy farmer
17 income. These efforts included the Northeast
18 Regional Cooperative Marketing Agency, RCMA,
19 many individual state price setting programs
20 such as in Maine, Federal order pricing in
21 2000, the Northeast Dairy Company, the Milk

1 Income Loss Contract, MILC program, and the
2 Cooperatives Working Together program. Any
3 proposal that lowers regulated producer milk
4 prices is not done lightly.

5 However, it is our belief that if
6 this manufacturing allowance distortion from
7 reality is not corrected, the income of
8 Agri-Mark members and all dairy farmers will
9 fall even more than the amount resulting from
10 our proposal. If not corrected, not only
11 will dairy farmer net earnings continue to
12 fall, severely disorderly marketing
13 conditions will result and jeopardize the
14 existence of local outlets for producer milk
15 in many areas of the country.

16 The impact of Agri-Mark members of
17 not correcting this problem has already been
18 discussed. Our members cannot keep bearing
19 millions of dollars in losses indefinitely.
20 The only reasonable alternative if nothing is
21 done is to consider closing or severely down-

1 sizing all our plants. Three times in the
2 past Agri-Mark members have stepped forward
3 and kept cheese plants open that were about
4 to close. Our members have invested tens of
5 millions of dollars of their own money in
6 these plants, as well as in our Massachusetts
7 butter/powder market balancing plant. They
8 have done this so they have local, orderly
9 markets for their own milk and that of their
10 neighbors. Agri-Mark is the only
11 organization in the Northwest that has
12 actually increased its plant ownership in the
13 past decade.

14 As already discussed, many dairy
15 farmer plants in the Northeast have already
16 shut their doors and others are taking less
17 milk. This has affected the local demand for
18 milk in the region. Whereas national supply
19 and demand conditions drive national dairy
20 product and national basic milk prices, local
21 supply and demand conditions drive over-order

1 premiums. The recent closings of so many
2 plants have placed great pressure on premiums
3 paid by all handlers. With fewer plants
4 buying milk, producers have lost bargaining
5 power in dealing with the handlers that
6 remain. Class I premiums have fallen by
7 \$0.20 per hundredweight in the past year and
8 will likely fall further if this situation is
9 not corrected.

10 In addition, as dairy manufacturing
11 plants close and eliminate local outlets for
12 producer milk, producer paid hauling costs to
13 more distant plants rise and disorderly
14 marketing conditions appear as more milk is
15 displaced and must find an immediate home.
16 Allied Cooperative Federation based in
17 northern New York expressed similar concerns
18 in their original letter to USDA supporting
19 Agri-Mark's' hearing request. As a result of
20 additional hauling costs and plant operation
21 losses from many large cooperative -- I'm

1 sorry. As a result of additional hauling
2 costs and/or plant operation losses, many
3 large cooperatives in the Northeast reduced
4 their member producer price differentials,
5 ppd, by \$0.10 to \$0.25 beginning in the
6 summer of 2005. Agri-Mark reduced our member
7 ppds by \$0.15 in July 2005.

8 In its notice on January 5th, 2006
9 announcing this hearing, USDA included an
10 economic analysis of the impacts of changing
11 Federal order make allowances. The analysis
12 concluded that producer blend prices would
13 likely fall from \$0.05 to \$0.13 per
14 hundredweight, on average, over the next five
15 years. As markets adjust and dairy product
16 prices rise, this impact will fall to the
17 \$0.03 to \$0.09 range. The impact on average
18 all-milk prices is likely to be even more
19 modest because, as I noted, producers'
20 bargaining power will be improved if losses
21 are reduced for management plants and if

1 cooperative manufacturers are able to recover
2 costs for the benefits of producer-owners of
3 plants.

4 The Agri-Mark proposal incorporates
5 manufacturing allowances changes for cheese
6 and butter that are very near the lower end
7 of the three scenarios discussed. However,
8 due to energy and other cost increases during
9 the past six or seven years, our proposal has
10 a greater change than USDA assumed for nonfat
11 dry milk and whey powder.

12 I believe that the impact of our
13 proposal will likely fall in the range
14 between scenarios 2 and 3. This implies a
15 \$0.09 to \$0.13 impact over five years and a
16 \$0.03 to \$0.06 longer term impact. However,
17 if these manufacturing costs issue is not
18 resolved quickly, the impact on dairy farmers
19 will be far greater than those amounts. Once
20 a company decides to close a plant, that
21 producer milk demand is usually gone forever.

1 We would ask the Department to
2 provide a similar economic analysis in the
3 final decision to document the likely impact
4 if our proposal is enacted.

5 EMERGENCY DECISION NEEDED THIS WINTER:

6 An emergency decision is needed this
7 winter so that order provisions can be
8 amended by early spring. All Class III and
9 IV manufacturers that operate plants using
10 Federal order milk are losing large sums of
11 money each and every day that goes by. USDA
12 has implemented amendments within sixty days
13 after the hearing in the past. Similar
14 expedition is justified in this case.

15 Agri-Mark members take on the risk
16 and responsibility of balancing the Class I
17 market and providing local outlets for their
18 milk and the milk of their neighbors.

19 Enactment of Proposal #1 means that
20 approximately \$700,000 per month in plant
21 margin losses can be avoided. Each day that

1 goes by without a decision means more than
2 \$22,000 to Agri-Mark members.

3 It is particularly important that the
4 amended manufacturing allowances be in place
5 in early spring. As already noted in Table
6 1, April, May and June are usually the peak
7 months when Class III and IV plants do the
8 most balancing for the Northeast Federal
9 order. Of those three months, May is the
10 most important from a balancing perspective.
11 As losses to the Class II and Class IV plants
12 keep mounting, those plants will likely be
13 willing to take less and less, which will
14 likely result in disorderly marketing
15 conditions and lower prices to dairy farmers.

16 Agri-Mark is one of the key balancers
17 of milk in the Northeast. Table 9 shows the
18 seasonality of component usage the our four
19 plants. It is also important to consider
20 milk component usage instead of just milk
21 usage since the growth in sales of lower fat

1 Class I products and high fat Class II
2 products create their own seasonality. For
3 example, the average butterfat test for
4 producer milk falls as summer heat begins in
5 late June. At the same time, butterfat
6 demand rises to meet Class II frozen dessert
7 needs. Table 9 shows that July Class IV
8 butterfat usage at our West Springfield plant
9 was only 77 percent of the annual monthly
10 average. As summer heat continued to take
11 its toll on butterfat tests and ice cream
12 sales increased at the same time, butterfat
13 usage at our plant was only 28 percent of the
14 annual monthly average in August 2005.

15 Nonfat solids supply and demand also
16 show large seasonality fluctuations that need
17 substantial balancing. Nonfat solids usage
18 remains strong in June and July as schools go
19 out of session and Class I sales decline.
20 July 2005 nonfat solids usage at our nonfat
21 dry milk plant was 138 percent of the annual

1 monthly average in July; however, that rate
2 fell to 90 percent in August and then 50
3 percent in September 2005 as schools came
4 back into session.

5 Class III component usage at our
6 cheese plants also balance seasonal changes
7 in producer milk production that Class I and
8 II plants cannot or will not balance due to
9 the perishable nature of their sales.

10 Generally, our cheese plants use about 105
11 percent of the annual monthly average in the
12 spring flush months of March through May
13 compared to about 92 in September and
14 October. Although less than Class IV volume
15 swings, our Class III plants do handle milk
16 swings in excess of 12 million pounds per
17 month. This is the equivalent of the monthly
18 milk production of about 80 dairy farmers.

19 If Class III and IV manufacturing
20 plants under Federal orders are to continue
21 to perform their crucial roles in balancing

1 Class I milk and milk component needs as well
2 as providing orderly local markets for dairy
3 farmers, those plants must have Class prices
4 that truly reflect the value of the milk to
5 their operations. The Agri-Mark proposal
6 aligns Federal order manufacturing allowances
7 with the average costs of manufacturing and
8 will allow such plants to continue as outlets
9 for producer milk and providers of key market
10 balancing services.

11 We urge the Department to quickly
12 review this hearing record and issue a final
13 interim decision as soon as possible so this
14 severe problem can be corrected no later than
15 this spring. Thank you for this opportunity
16 to present our concerns and proposed solution
17 for your consideration.

18 Thank you, Mr. Wellington.

19 You referred in the course of your
20 testimony to nine tables attached and there
21 are nine numbered tables attached following

1 Table 9 which was inadvertently omitted and
2 inserted. There is a document which has
3 Exhibit blank, USDA approved dairy plants to
4 which you refer on page 8 of your testimony.

5 I think it will be helpful for Your
6 Honor just to pencil in Table 10. It is the
7 next consecutive table in the exhibit.

8 THE JUDGE: Following table 11.

9 MR. VETNE: Following -- we have 9
10 printed tables, 8 and then 9, and that table
11 and then an energy outlook document.

12 THE JUDGE: Which would be table 11.

13 MR. VETNE: Table 11.

14 BY MR. VETNE:

15 Q. Mr. Wellington, is the four pages
16 that consist of your penciled in as table 10,
17 are those the excerpts of American cheese
18 plans to which you refer on page 8 of your
19 testimony, some of which produce whey and
20 milks?

21 A. Yes, that's true.

1 Q. And that is simply data taken from
2 the publication by Dairy Programs, dairy
3 plants surveyed, approved for USDA grading
4 service?

5 A. Yes, it is.

6 Q. Okay. And there is one more
7 attachment, which we can pencil in as table
8 11, even though part of it is not a table.
9 Short-term energy outlook, you refer on page
10 10 of your testimony to Department of Energy
11 projections of energy prices for 2006 and
12 2007. And at the top of this page, it says,
13 This is an excerpt consisting of page 1 and
14 figures 1 through 3 of a 52-page document.
15 And that is the data to which you referred on
16 page 10 of your testimony.

17 A. Yes, it is.

18 MR. VETNE: And, Your Honor, although
19 I will have other requests for official
20 notice all at one time, tomorrow morning this
21 is probably a good place to do it. I'd like

1 to request official notice of the published
2 USDA dairy plants surveyed and approved for
3 grading service, publications for 1998 to
4 date. 1998 was the last year in which we had
5 a cost survey, so the plants and changes in
6 plants since that time, I think it would be
7 helpful for reference.

8 THE JUDGE: Very well.

9 MR. VETNE: And the other document is
10 the full document of the Department of
11 Energy's short term energy outlook. This one
12 was released in January of 2006. It's a 52-
13 page document which gives information on
14 projected prices and supplies for various
15 energy sources. I would like to request
16 official notice on that, as well, Your Honor,
17 within the briefing period of the next
18 edition of the short term energy outlook
19 which is scheduled to be released on February
20 7.

21 THE JUDGE: Subject to its being

1 released.

2 MR. VETNE: Subject to its being
3 available at the time of briefing, but
4 February 7th, I think you said. I know that
5 we may have a couple more --

6 BY MR. VETNE:

7 Q. Bob, look at page 5 of your
8 testimony.

9 A. Yes.

10 Q. Near the bottom of the page, about 10
11 lines up, there's a 40-pound block with \$.018
12 cents.

13 A. That should be \$.018 without the
14 cents.

15 Q. Without the cents.

16 A. Right.

17 Q. And on -- let's see.

18 A. There are a couple of others there.

19 Q. There are several of those there.
20 Wherever there appears to be a dollar sign --

21 THE JUDGE: Page 9.

1 MR. VETNE: Page 9, there are two of
2 them near the bottom of the page.

3 THE JUDGE: One at the top, first
4 paragraph?

5 MR. VETNE: As well as at the top,
6 about seven lines down from the top of the
7 page, \$0.19 or --

8 A. Those really default to the dollar
9 sign.

10 Q. Okay. And the bottom of the page
11 about two-thirds of the way down, the price
12 of butter --

13 A. Butterfat false, .044, that cents
14 should be removed also.

15 Q. And the next line, same thing?

16 A. Yes

17 Q. And the next line, same thing. And
18 the bottom of page 11, three places, same
19 thing?

20 A. Absolutely.

21 Q. Those are all --

1 A. Cents, yes.

2 Q. Those are all dollars, actually,
3 point-something dollars.

4 A. Remove the cents from those.

5 THE JUDGE: Also on page 12, his
6 this, additional hauling costs, I suppose
7 additionally?

8 BY MR. VETNE:

9 Q. Yes, on page 12, next to the last
10 line. You read "additional" hauling cots
11 rather than --

12 A. I corrected that, hopefully, for the
13 record.

14 MR. VETNE: And there may be one or
15 two others. We're going to have a chance to
16 see you again tomorrow morning, I think.

17 So, Your Honor, with those
18 clarifications and references, I ask that the
19 exhibit with attachments be received.

20 THE JUDGE: So admitted.

21 [Whereupon, Exhibit No. 29

1 was received in evidence.]

2 THE JUDGE: Ms. Deskins, do I hear a
3 motion to adjourn?

4 MS. DESKINS: Yes, Your Honor, we
5 move to adjourn the hearing until tomorrow
6 morning.

7 THE JUDGE: And what time would you
8 all like to start? 8:30 again? 8:30 it is.
9 I look forward to seeing all of you tomorrow
10 morning.

11 [Whereupon, the hearing adjourned
12 at 4:58 o'clock p.m.]

13

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