

COPY

VOLUME VII

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

In the Matter of Proposed) Docket Numbers
Amendments to Tentative) AO-14-A77, et al.
Marketing Agreements and) DA-07-02
Orders)

National Public Hearing

Tuesday, April 10, 2007

9:08 o'clock a.m.

Radisson Hotel Circle Centre

31 West Ohio Street

Indianapolis, IN 46204

BEFORE:

JUDGE VICTOR W. PALMER

U.S. ADMINISTRATIVE LAW JUDGE

UNITED STATES DEPARTMENT OF AGRICULTURE

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Indianapolis, IN 46282

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A P P E A R A N C E S

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A P P E A R A N C E S (Cont.)

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A P P E A R A N C E S (Cont.)

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1 **JOHN ROETLIN,**
2 having been first duly sworn in by the Judge,
3 was examined and testified under oath as
4 follows:

5 **STATEMENT OF JOHN ROETLIN**

6 **JUDGE PALMER:** All right. Let's get
7 started. Sir, would you give your -- we're on
8 the record. Would you give your full name, sir.
9 Your name.

10 **MR. ROETLIN:** John Roetlin.

11 **JUDGE PALMER:** Spell it for the reporter.
12 Spell your name.

13 **MR. ROETLIN:** R-O-E-T-L-I-N.

14 **JUDGE PALMER:** All right. And you own a
15 cheese plant?

16 **MR. ROETLIN:** Yes, sir. I own Twin County
17 Dairy at Kalona, Iowa.

18 **JUDGE PALMER:** You want to bring that
19 microphone a little closer to you. They're
20 having a little trouble hearing.

21 **MR. ROETLIN:** Can you hear me?

22 **JUDGE PALMER:** Now we can.

23 **MR. ROETLIN:** Okay. Kalona is spelled
24 K-A-L-O-N-A, Iowa, IA.

25 **JUDGE PALMER:** All right. Sir, and you've

1 looked at the proposals that are here, I gather,
2 and you want to give some -- your thoughts on
3 some of these proposals.

4 **MR. ROETLIN:** Yes, sir. I just -- my
5 testimony is not going to take very long. Can
6 everyone still hear me?

7 **JUDGE PALMER:** Go ahead and tell us what
8 you wish to say, sir.

9 **MR. ROETLIN:** I've never been to one of
10 these proceedings. I don't have a clue what
11 goes on.

12 **JUDGE PALMER:** They don't either. They
13 don't either.

14 **MR. ROETLIN:** I think that's probably
15 right.

16 **JUDGE PALMER:** All right.

17 **MR. ROETLIN:** I know that there's probably
18 not too many cheese plant operators here, I can
19 tell you that, because if there were, if they
20 had something to do with it, they wouldn't be
21 doing the way the present formula is set up.

22 Our company is a private company. It's
23 owned by the family. My father started it with
24 a bunch of Amish and Mennonite farmers in our
25 area; as a matter of fact, 32 of them. And it

1 was a cooperative type of an operation, but my
2 father, he had the cheese equipment, and the
3 farmers' cooperative had the building. It's one
4 of those old Wisconsin type of cheese operations
5 where they had a cheese maker and he worked on a
6 percentage. That was in 1947.

7 In 1967, myself, my father and my brother
8 bought the co-op out. In 1970 my brother and
9 myself bought my father out. In 1985, I'm the
10 only standing survivor here.

11 I'm not going to go over the 1 through 19
12 proposals because I think everybody in this room
13 knows what they are, and we've been -- they've
14 probably been across it a million times.

15 Shall I just continue here?

16 **JUDGE PALMER:** Go ahead, sir. If you want
17 me to ask you some questions, I will, but I
18 thought it'd be easier for you to just give a
19 statement.

20 **MR. ROETLIN:** And everyone can hear me,
21 right?

22 **JUDGE PALMER:** Yes.

23 **MR. ROETLIN:** I think for us -- I believe
24 Dave Stutenburg, is that correct, I did talk to
25 him and I wanted to make sure that when the whey

1 allowance or the whey was put into the order was
2 the year 2000.

3 Since 2000 to present, our company has only
4 made money two years. And we're a pretty
5 efficient company. We have myself, and my wife
6 is the secretary, we have 55 employees. That
7 goes with semi drivers, so we think we're pretty
8 efficient. And we feel that we have this cut to
9 the bone. And it just isn't there.

10 We have a lot of people in this room that
11 are paid to put that formula together, I
12 believe. We have a lot of suggestions I think.
13 We have a lot of operators, probably farm
14 groups, farmers, maybe some cheese plant
15 operators of different types, co-op, private,
16 large corporations, whatever.

17 Where I sit, I don't know what to do about
18 what we have going on, but, like I said, we've
19 only made money two years since 19-- or since
20 2000.

21 I think I agree with maybe some of the
22 proposals where they're talking about we need to
23 have faster or quicker changes in the Order.
24 Maybe what was good in 2000, 2001, isn't good
25 today. Everybody knows what the whey price is.

1 And it's almost impossible, when you look at
2 those other solids prices, to make money.

3 And I think one of the other things I want
4 to say is the plants that invested in whey
5 operations, the plants spent that money. When I
6 say plants, I'm talking about myself, and I
7 don't know, I assume the farmers' cooperatives
8 or large corporations would be the same thing,
9 but a large share of that money that's coming in
10 is going right back to the farmer or however
11 they -- whatever that formula is, and I think
12 somebody needs to look at that.

13 I really don't have any more. I don't know
14 if this is the way I'm supposed to do it, but
15 this is the way I feel.

16 **JUDGE PALMER:** Well, what we're going to
17 do, we're going to let some of these folks ask
18 you some questions.

19 **MR. ROETLIN:** I might want to add, I'm a
20 little hard of hearing. My wife says I'm very,
21 very hard of hearing, so.

22 **JUDGE PALMER:** The first man who wants to
23 ask you some questions is John Vetne I think.
24 John is going to speak loudly because John
25 sometimes speaks softly.

1 **MR. VETNE:** My wife says I'm hard of
2 hearing.

3 **JUDGE PALMER:** Yeah, I know.

4 **EXAMINATION,**

5 **QUESTIONS BY MR. JOHN H. VETNE:**

6 Q Good morning, Mr. Roetlin. My name is John
7 Vetne. I'm an attorney for Agri-Mark and other
8 cooperatives who are proponents of several
9 proposals for make allowance and other parts of
10 the formula.

11 What kind of cheese does your plant make?

12 A My plant makes 500-pound barrels, cheddar, for
13 Kraft.

14 Q Cheddar?

15 A Cheddar.

16 Q Okay. And all of your production is contracted
17 to Kraft?

18 A Yes, sir.

19 Q Are the sales of -- are the sales of cheese to
20 Kraft and the prices for those sales surveyed by
21 NASS, do you know?

22 A NASS.

23 Q You report to NASS --

24 A Yes.

25 Q -- the sale prices?

1 A Yes.

2 Q What is the production volume of your plant
3 annually?

4 A From a million to a million and a half pounds.
5 If we fortify our production equipment, would be
6 1.5 million. If we use just straight milk, it's
7 about a million pounds.

8 Q Million pounds of --

9 A Milk.

10 Q Of milk per?

11 A Day.

12 Q Per day?

13 A Right.

14 Q You indicated that your plant has invested in --
15 in whey processing equipment; is that correct?

16 A That's correct.

17 Q What kind of whey processing equipment?

18 A We do UF, make WPC and also concentrated
19 permeate.

20 Can everybody hear me okay? Okay.

21 Q Do you process all of the whey by-product that
22 is produced by your plant?

23 A Yes, sir, we do.

24 Q Do you process whey from other plants?

25 A No, we do not. I can go into that just a little

1 bit more. There's only about -- in the state of
2 Iowa, there's only -- I believe there's four
3 cheese plants, and so geographically it's -- you
4 know, doesn't work too well.

5 Q You indicated that you've -- your plant has made
6 money only in two years since 2000. What was
7 your profitability during the decade before
8 2000?

9 A You mean in dollars?

10 Q No, how many of those ten years --

11 A We always made money.

12 Q Okay.

13 A Some years -- excuse me.

14 Q Go ahead.

15 A Some years we didn't make what we liked, but we
16 always were able to pay the bills and had some
17 profit.

18 We had a profit in 1999, of course, and in
19 2000 it started to go down, and from 2000 to
20 2006 we have had two plus years. One of them
21 was 2000 in the beginning of the other solids
22 pricing, and the other profit year was 2003.
23 And when I say profit, it depends on whose bank
24 account you're looking at, but it wasn't very
25 large. It was several hundred thousand dollars,

1 well under half a million. So for all practical
2 purposes, you could say that from the beginning
3 of the other solids pricing to today, we
4 probably had one year that we made money, a good
5 amount of money.

6 Q Okay. And when did you make this investment in
7 whey processing equipment?

8 A We actually started -- in 1985 we put in a RO
9 system and ran that for a number of years, and
10 last year, 2005, we put up a facility to further
11 process whey. It's not that we had the money.
12 We went to a friendly banker and got it and put
13 it together. And when we first built the
14 building in '05, the pricing of WPC and
15 everything else was very high, somewhere around,
16 I believe it was 78 cents. And as we got it
17 going, the price went down all the years to
18 2000, and then toward I think about the middle
19 of the year of 2000 the pricing of WPC and
20 permeate started to go up. At first when we
21 started making permeate, we were practically
22 giving it away. But today it's a little bit
23 better story than that. But the other solids
24 pricing has taken -- taken all of it. I mean
25 we're processing the product and we're just

1 taking the money from that just to pay -- pay
2 for the milk and pay for the -- it's no profit.

3 Q Okay. You say you built a building in 2005?

4 A Correct.

5 Q What building was that?

6 A It was a whey processing plant. It was
7 ultrafiltration, RO, and then of course we
8 polish our water and use that for cleanup and
9 whatever. And we also have an evaporator where
10 we evaporate the permeate.

11 Q So you made a substantial investment in plant
12 equipment to process whey?

13 A Yeah.

14 Q And that investment was made in 2005?

15 A That's correct.

16 Q When was it complete?

17 A It was -- our first day of operation with it was
18 February 27th, I believe, of 2006.

19 Q So it's been in operation for over one year?

20 A Yes, sir.

21 Q And during -- during that year, have you been
22 able from your sale of products to make payments
23 on the cost of that investment?

24 A No.

25 Q And is the reason for that the difference

1 between -- there's an inadequate margin between
2 what you receive for your product and what you
3 have to pay for milk?

4 A That's correct.

5 Q The milk that you receive comes from what
6 source? Who sells you milk?

7 A The -- most of the milk that we receive we
8 receive from -- we buy from Swiss Valley Farms,
9 we buy from Dairy Farmers of America, we buy
10 from Prairie Farms, we buy some from NFO, so we
11 pretty much buy most of the milk around our
12 geographic area, it's produced in that area.
13 But those are the major suppliers.

14 Q Do you -- are you filing reports to the market
15 administrator for your use of the milk or do
16 your sellers, your suppliers file those reports?

17 A I don't understand the question for sure.

18 Q Are you regulated by USDA, your plant?

19 A We're a USDA plant. We're inspected USDA. I
20 don't know if that's what you mean.

21 Q Okay. You're inspected for your plant
22 facilities, but your plant is not price
23 regulated?

24 A Yes, we are. We buy the milk from DFA, Swiss
25 Valley, those people. We are regulated, so

1 we -- our pricing is priced through the Class
2 III price plus.

3 Q Okay. So your -- DFA or Swiss Valley, they have
4 to pay the Class III price and that's what they
5 charge you?

6 A Correct.

7 Q Do you know how many producers supply your plant
8 on average?

9 A How many producers would be involved in that?

10 Q Uh-huh.

11 A Probably 350, maybe 400. That's a guess. I'm
12 not real sure, but that's -- that's close.

13 Q Okay. Does your plant regularly receive milk
14 from the same producers day after day?

15 A Yes, we do.

16 Q Do your contracts provide for a regular,
17 committed supply from --

18 A Yes, it does.

19 Q -- from DFA or Swiss Valley?

20 A Yeah.

21 Q Do you receive additionally milk that is not
22 committed to you? You get a call saying are you
23 willing to take an extra load today?

24 A From those particular people or somebody else?

25 Q From those people or anybody else.

- 1 A Both. We sometimes call, we're short, don't
2 have enough or would like to have more and then
3 call, but --
- 4 Q So sometimes you look for milk?
- 5 A Sometimes I look for milk, and I don't know why.
- 6 Q And sometimes other people look to you to buy
7 milk?
- 8 A The question is what?
- 9 Q Sometimes you call others?
- 10 A I call others, they call me.
- 11 Q It goes both ways?
- 12 A They know that we have -- that we help a lot of
13 these co-ops with milk supply and holidays and
14 if there are -- if they're long, we help them.
15 Sometimes it's a little bit harder to rake them
16 over a tree stump to get milk when it's short,
17 you know what I mean, but, like I said, I don't
18 know why we do that. I would be better off just
19 leaving the milk where it's at and forget about
20 this for --
- 21 Q All right. You currently make milk into cheddar
22 cheese in 500-pound barrels?
- 23 A Yes, sir.
- 24 Q Have you made cheese in any other form in recent
25 years --

1 A Well --

2 Q -- blocks or smaller barrels?

3 A Yes, we have. We've done that, I've made --
4 we've made six or seven different kinds of
5 cheese. I made Swiss cheese, I made about
6 everything there is out there.

7 Q Say since 1990, have you made a variety of
8 cheeses?

9 A No. Cheddar since 1990.

10 Q It's all been cheddar. And since 1990 has it
11 all been in 500-pound barrels?

12 A Pretty much, yeah.

13 Q And has it -- does it all go to Kraft?

14 A Yes, sir.

15 Q Do you deliver your product to Kraft?

16 A We have trucks, so we charge -- we deliver, but
17 we charge. There's a haul rate that you -- that
18 is assigned to us.

19 Q Where is it delivered? Where is the product
20 delivered?

21 A Allentown, PA; New Ulm, Minnesota; Springfield,
22 Missouri; and Champaign, Illinois.

23 Q Do you know how Kraft uses your product?

24 A Some of it goes into a -- into a cave down in
25 Springfield. I don't know what they do with it.

1 Sometimes they've aged it. I think primarily it
2 goes to American slices. We kind of have a
3 niche market with them because of our body, it
4 has a certain body, our cheese; therefore, it
5 works well for them to blend it with -- with
6 some of the other products that they have.

7 Q When you make cheese, your by-products are --
8 you get whey skim and whey cream; correct?

9 A Correct.

10 Q What do you do with your whey cream?

11 A We sell our whey cream to a creamery. The name
12 of the company is Alcam Creamery out of --

13 Q How do you spell Alcam?

14 A Alcam, A-L-C-A-M, I believe it is, out of
15 Wisconsin somewhere, I'm not sure where, what
16 the -- what the city is that they're from, but.

17 Q Do you truck it to Alcam?

18 A No. They pick it up.

19 Q How frequently do they pick it up?

20 A They pick up three times a week.

21 Q And when they pick it up from you, do they pick
22 up milk from any others that you're aware of?

23 A Any other creamery or --

24 Q Any other cheese --

25 A Yeah, Wapsie Valley in Independence, Iowa. They

1 pick up that cream also.

2 **JUDGE PALMER:** John, I think we're getting
3 more detail than we really need. The basic
4 testimony is that the whey price is too high.
5 We've got a pretty good understanding of his
6 operations at this point, so maybe you just want
7 to move on to something else.

8 **MR. YALE:** Your Honor, could I speak? I
9 think I know where John's going, and it's not a
10 position that we take. By the way, Benjamin F.
11 Yale, Select.

12 But one of the things that's really
13 important is having this information of what
14 goes on in the plants so that we do know where
15 the whey cream comes from and how it's sold and
16 stuff. I think it's valuable. I mean I'm
17 not -- I wish that he'd said another answer, but
18 I think it's valuable information.

19 **JUDGE PALMER:** Well, then, I'll let him
20 continue. Go ahead, John.

21 **MR. VETNE:** I'm adopting him. This is no
22 longer Cross, Your Honor. This is Direct. I'm
23 adopting this witness as my own and I'm asking
24 him Direct questions.

25 **JUDGE PALMER:** Go ahead.

1 **MR. YALE:** No leading questions then, John.

2 **JUDGE PALMER:** You've been adopted. You've
3 been adopted.

4 **MR. ROETLIN:** Well, if they keep going, I'm
5 not always politically correct. I think
6 that's --

7 **JUDGE PALMER:** All right.

8 **MR. VETNE:** And I would encourage you to be
9 politically incorrect.

10 **BY MR. VETNE:**

11 Q When you sell whey cream, how is that priced?

12 A I believe it's 1.15 over -- I stand to be
13 corrected, but I think that's the price that we
14 get.

15 Q Well, there's no way to correct you.

16 A Yeah.

17 Q Whatever -- your belief is that it's 1.15
18 over --

19 A I believe it -- it's either 1.12 or 1.15. I'm
20 not sure.

21 Q Is that 1.15 or 1.12?

22 A I think it's 1.12 or 1.15.

23 Q Over what?

24 A Over Chicago, I believe, is that -- is that
25 the -- that's the multiplier over -- over the

1 butter market, I believe. Somebody in here help
2 me out on this?

3 **JUDGE PALMER:** They're not going to do
4 that.

5 **MR. ROETLIN:** Is that Bob Wellington back
6 there?

7 Q Is that somebody else's responsibility in your
8 operation, the sale of --

9 A It's mine and someone else's, but I mean that
10 was set up a couple years ago, and that's about
11 all we can get.

12 Q Okay. And to whom do you sell your whey
13 products?

14 A We sell our whey product to Land O'Lakes. We
15 sell it to Bongard's. We sell it to Litchfield.

16 Q Litchfield is?

17 A Litchfield, Minnesota. Bongard's is in
18 Minnesota. Land O'Lakes is in Minnesota.

19 We sell it to Protient. Protient,
20 P-R-O-T-I-E-N-T.

21 I think based on the fact that we're
22 selling to Bongard's and to Land O'Lakes, it
23 tells you that our product is pretty good.

24 Q All right. When you make cheese, when you make
25 cheddar cheese, do you recycle whey cream into

1 your vat?

2 A We do not. The people that we sell cheese to
3 don't really -- they don't really like that.
4 Some buyers, some cheese buyers don't care or --
5 but Kraft does.

6 Q When you make -- when you make cheese, do you
7 fortify with milk solids from any source?

8 A We had till the price got where it's at right
9 now. I think it's -- as some people in here
10 probably know, I think it's about a buck
11 sixty-five, something like that, and, you know,
12 I --

13 Q A buck sixty-five for what, sir?

14 A A pound of powder or solids, however you want
15 to -- on powder.

16 Q On powder?

17 A On skim, nonfat dry milk.

18 Q Okay. And would you fortify with powder or
19 condensed or both?

20 A We've done both. We've bought -- we've bought
21 some UF out of New Mexico and -- but now, you
22 know, I think the way the whey price is now, you
23 can't -- you can't afford to do that either
24 because when they UF that milk, some of your
25 lactose goes and now it's something that we want

1 to sell, so we don't -- we just don't buy it.

2 Now, we do buy -- also buy cream. We
3 fortify back into the cheese vats with the
4 cream, and the price currently, we can do that,
5 but.

6 Q Do you buy cream throughout the year or are you
7 more likely --

8 A Pretty much throughout the year. And that, by
9 the way, is not 1.12 or 1.15. That's 1.28.
10 That's the multiple on that. And I think that's
11 kind of a standard price for cream, I think,
12 1.28 over Chicago I think, so that -- that we do
13 do. But then we turn around and sell it for
14 1.12 or 1.15, so.

15 Q You buy it for 1.28 --

16 A The only thing we would be selling would be what
17 would be left over in the whey, so. It's kind
18 of okay, I guess.

19 Q Do you know what the composition, the average
20 composition of milk that you get from dairy
21 farmers is at your plant, butterfat content,
22 protein content?

23 A Pretty much, yeah.

24 Q What is that?

25 A 3 point -- I believe it's 3.6 something on the

1 fat or 3.7. 3.2, I believe, on protein, and I'm
2 not sure what the other solids is.

3 Q Okay. Do you -- because you sometimes -- you
4 sometimes add cream and add --

5 A We add cream all the time.

6 Q You add cream all the time?

7 A Yeah.

8 Q What is the composition of the milk in your vat
9 including added cream, added solids, do you
10 know?

11 A About -- I believe it's about 3.8 or 3.9,
12 something like that.

13 Q Fat?

14 A Yeah, fat.

15 Q So the protein portion would be a bit lower,
16 then, if you're just adding fat?

17 A Since we're adding the fat?

18 Q Yeah.

19 A That'd probably be right.

20 Q So something less than 3.2?

21 A Yeah.

22 Q What is -- how many pounds of cheese do you get
23 from your vat per hundred pounds of milk in your
24 vat at 3.8 percent fat?

25 A That, of course, is seasonal, you know what I

1 mean, in our area. It's from about, I believe
2 it's October to January or so, it's -- maybe we
3 yield about 10 pounds, something like that, and
4 then after January the yields start to go down,
5 and we get into July or something like that, we
6 would probably have about 9.0 yield; in other
7 words, nine pounds of cheese for hundred pounds
8 of milk.

9 Q Is that from a hundred pounds of milk from
10 producers or a hundred pounds in the vat?

11 A Hundred pounds in the vat.

12 Q In the vat. So the yield -- since you're adding
13 cream, the yield from producers would be
14 somewhat less?

15 A That's correct. I believe that before we
16 started to fortify it, we'd probably get
17 something like 8.7 or 8.8 pounds of cheese.

18 Q Before you started to fortify?

19 A Before we started to put cream in, yeah, and
20 then sometimes fortify with dry milk and
21 whatever.

22 Q When you use the term fortify, you're talking
23 about added fat as well as added nonfat solids?

24 A Correct, yeah.

25 MR. VETNE: I think I'll let some other

1 people ask some questions. I might have some
2 more. Thank you very much.

3 **THE WITNESS:** Thank you.

4 **JUDGE PALMER:** You're now in his will, I
5 understand.

6 Other questions? Mr. Yale.

7 **EXAMINATION,**

8 **QUESTIONS BY MR. BENJAMIN F. YALE:**

9 Q Good morning. My name is Ben Yale, and I
10 represent Select Milk Producers, Dairy Producers
11 of New Mexico, Continental Dairy Products, Lone
12 Star Milk Producers and Zia Milk Producers.

13 You indicate that you both fortify and
14 bring in cream. Is that all at the same time
15 that you'll add additional cream and then also
16 bring in other solids for your vat?

17 A Well, like I indicated earlier, we -- when the
18 price of dry milk was less or UF milk, some of
19 the people you represent, we would do both. We
20 would bring the dry milk or the condensed or the
21 UF milk, and also if -- see, we're going into
22 skim, so we have to add fat back, otherwise our
23 FDBs would be way too low on the cheese.

24 Q Right. And part of the thing of it is you got a
25 fairly high level of protein coming in in your

1 producer milk. I mean you have a fat-to-protein
2 ratio that's relatively narrow compared to some
3 milk, isn't that true, or you don't know? Your
4 3.2 percent protein is somewhat high, is it not?

5 A But that wouldn't be year around. That would
6 be -- I'm talking about months like October to
7 maybe January, but here oftentimes when we go
8 past February or March, we would end up 3.0 or
9 2.9, you know what I'm saying.

10 Q Right. And at those times, that's when you
11 would need to bring in some additional solids so
12 you could use all the fat that you have in the
13 vat; is that correct?

14 A That's true.

15 Q And then maybe in that period when you're at the
16 3.2 percent protein, you may need fat in order
17 to use up all of the solids; right?

18 A I don't understand the question.

19 Q I mean if your fat-to-protein ratio is low
20 because the protein test is high, then you would
21 need to buy additional cream in order to get
22 your fat ratio up?

23 A Correct. And, of course, we're limited by the
24 cheese buyer what -- how much fat you're going
25 to have in there, because you put too much fat

1 in, then your body goes to hell, whatever, so
2 you're kind of playing a game of running
3 between, so.

4 Q Just hearing you talk, I get the impression you
5 try to produce, what, a full fat cheddar, is
6 that how one would describe it?

7 A That's correct.

8 Q You have about as high a percentage of butterfat
9 as you can get into your cheddar, is that -- I
10 mean to the point -- I mean obviously there is a
11 limit, the casein can only hold so much, but.
12 You don't -- you don't know the answer to that?

13 A No.

14 Q By the way, when you said you sold the whey
15 cream FOB, is that FOB your plant or is that FOB
16 the -- the price that you sell your whey cream,
17 is that FOB the plant, your plant?

18 A That's correct, yeah.

19 Q Now, you, because you sell to Kraft, do not
20 recycle your whey cream?

21 A That is correct.

22 Q But that is a process that is used by other
23 cheese makers?

24 A I think it is.

25 Q Now, I want to talk -- this issue with the whey

1 solids, I think you bring up an interesting
2 point. I think it is a -- it's a problem that
3 the Secretary needs more information on. And
4 although I represent producers and we like to
5 see the higher whey value, I think we also
6 understand some of these situations and what's
7 going on.

8 You do not make any sweet whey powder;
9 right? You concentrate all of it?

10 A We do not.

11 Q All right. Now, you said you do whey protein
12 concentrates. Do you do any WPIS as well or you
13 just --

14 A No, we do not. You mean like 90s, 80s and 90s?

15 Q Right.

16 A Yeah. No.

17 Q You don't do that?

18 A No.

19 Q So you're like WPC 50 or 40?

20 A 55.

21 Q 55?

22 A Yes.

23 Q Okay. And the -- when you sell -- I don't need
24 to know the price you sell it at, but do you
25 have a reference price, like you were talking

1 about that your whey butter is the Chicago price
2 times some multiplier; right?

3 A Yes.

4 Q Okay. When you sell your WPC, is there some
5 reference price that you use and we say we'll
6 sell it at this plus or this times the number or
7 something like that?

8 A Yes.

9 Q What do you use for that?

10 A We use the 34 market.

11 Q Oh, the WPC 34?

12 A Yes.

13 Q And then just adjust it for the amount of
14 protein?

15 A Correct.

16 Q So that WPC 34 to 35, so that's --

17 A Yeah, this is a -- we take 34 market, we take
18 the mostlies of the 34, subtract a -- I guess
19 you would say a make allowance type of thing or
20 minus, some people sell it 13 cent, minus 13,
21 minus 15 or whatever, so you end up with a --
22 just say, for example, it's 80 cents, say the
23 mostly market is 80 cents for 34, say you minus
24 15, so that ends up in your formula, your mostly
25 price would be 65 cents.

- 1 Q Right.
- 2 A Did I do that right?
- 3 Q Yeah.
- 4 A Okay. And then you divide that by 34.
- 5 Q Okay.
- 6 A And then you come up with a price of three
7 dollars and something per pound of protein and
8 then you multiply that by the amount of solids
9 in the tanker, so you're coming out with --
10 current pricing, you're probably coming out with
11 \$18,000 a load maybe, something like that, on
12 WPC.
- 13 And then your permeate formulas is the
14 same. We go off of the lactose market, and
15 there'd be a minus in that also because it's
16 liquid.
- 17 Q Right. Let's talk just so that we have that
18 clear in the record. The permeate is -- prior
19 to -- as I understand your process -- well, as
20 part of fortifying, you UF, ultrafilter, the --
21 the whey?
- 22 A We do.
- 23 Q Yes.
- 24 A Yes.
- 25 Q All right. And what that does is that

1 concentrates the proteins?

2 A Takes the protein in one stream and takes the
3 permeate into another one.

4 Q Which is mostly the lactose?

5 A Which runs through -- right, which is the
6 lactose is -- it's just mostly lactose.

7 Q Right.

8 A Goes through an RO, we condense it up to
9 maybe -- whatever percentage, 27, 28 percent.
10 Then we run it through an evaporator, get it up
11 to 45 percent, something like that.

12 Q And that's pretty much a wash in terms of what
13 the lactose is worth? Are you able to make --
14 lactose market I guess is better today, but in
15 the past it's just finding a way to get rid of
16 the lactose; right?

17 A Lactose is better. WPC is better. The whey
18 price is too much to justify in the other two,
19 but.

20 Q All right. I want to ask this question, and
21 maybe you know the answer, maybe you don't. But
22 you indicated that you got at some times of the
23 year 3.7 percent butterfat and 3.2 percent
24 protein from your producer milk that comes in,
25 and you produce the cheese and there's a whey

1 stream that comes off. And then that -- out of
2 that whey stream you remove the whey butter,
3 right, and you sell the whey butter, and then
4 what's left of that whey skim you then run
5 through this RO, evaporator and the drier to
6 come up with both a WPC powder or maybe -- and
7 then a permeate that you come up with; right?

8 A Correct.

9 Q Now, have you ever determined that out of a
10 hundred pounds of milk that comes into your
11 plant, how many pounds of solids of the whey
12 proteins and the lactose and the other show up
13 in that whey skim? Do you know what that ratio
14 is?

15 A The -- yes. We figure that all the time. We
16 figure what the other solids price is, and we
17 end up with what our whey would bring us, which
18 is WPC for us and permeate, so there's a
19 combination of those two. I believe it's adding
20 three dollars and some cents to the other solids
21 price, and we use that number, and without
22 assessing any costs to the operation, we would
23 make a profit on that whey operation, but once
24 you assess your cleaning and your CIPing and --
25 it's a wash. Is that your question?

1 Q Well, you answered the next question, so that's
2 fine, but --

3 A I don't know if I can or not.

4 Q Well, here's the thing. Are you familiar with
5 the Class III formula for setting prices in
6 terms of how you pay for the components?

7 A I'm sort of familiar with it. You mean how it's
8 generated, how you end up with the price?

9 Q Right.

10 A Yeah, you get -- yeah, I think I am.

11 Q Okay. Now, in the -- you end up paying per
12 pound so much for the other solids that come in
13 from the producer of milk; right? There's
14 that --

15 A Yeah, right.

16 Q Okay. How does the pounds of other solids that
17 you pay for that comes in the plant compare to
18 the pounds of other solids that actually show up
19 in the whey skim that you're able to turn into
20 WPC or lactose?

21 A I think I answered that. It turns --

22 Q I'm talking in pounds or percentages. Can you
23 say that? You get like about 5.8 pounds of
24 other solids in your milk coming in or 5.7, 5.8?
25 Do you know what that number is?

- 1 A Yeah.
- 2 Q Somewhere in that range?
- 3 A Yeah, something like that.
- 4 Q All right. So you go through -- so let's say
5 for the moment you just had a hundred pounds of
6 milk come through, okay, and you process that
7 into cheese, okay, and some of those other
8 solids stay in the cheese, right, a small
9 amount?
- 10 A I suppose some would, yeah.
- 11 Q Okay. My question is at that point how many of
12 those show up in the whey stream or the
13 permeate?
- 14 A Well, I'd have to look at the formula pricing.
15 They say 5.69; is that correct?
- 16 Q Yeah, something like that. I mean it comes
17 out --
- 18 A I don't think -- you know, you're not going to
19 get that.
- 20 Q That's my question. I'm trying to figure out
21 what that --
- 22 A And I can't -- I'm not prepared to give you that
23 because I don't have that.
- 24 Q That's okay. Well, you're given a lot of
25 information. I appreciate that very much.

1 A And, like I say, it's not 5.69, I can tell you
2 that, so.

3 Q Now I want to go back to just two other issues
4 that you addressed. I want to just give you
5 three statements you've made, then I want to try
6 to tie them together.

7 You indicate that it's not been profitable
8 the last seven or eight years, which you
9 attribute probably to the whey, the other solids
10 price, and you also made a statement that you
11 pay a premium for your milk over and above the
12 Class III price from your suppliers.

13 A Yeah.

14 Q All right. And I guess the question is that
15 have you looked to see if the elimination of the
16 premium would be sufficient to create the
17 profitability or do you also need to have an
18 adjustment in the other solids over and above
19 that to establish that profitability? I don't
20 need an exact number.

21 A Well, anytime you can cut a cost, you're going
22 to cut a premium or cut it -- whatever it is
23 that you want to call it, but it's definitely --
24 other solids is definitely probably one of our
25 biggest problems.

1 Q Right.

2 A At least currently. I mean we're putting the
3 money in, but it looks like you're taking this
4 money and giving it to somebody else because
5 you're not getting it, you know what I mean.

6 Q Right. So let me just rephrase the question and
7 see if this is the answer, is that if your
8 premiums that you paid for your milk
9 disappeared, you would still need to have some
10 relief on the other solids for profitability?

11 A The premium we've paid for years.

12 Q I understand.

13 A We paid the premium prior to the other solids
14 ever going into the -- to the formula, and it's
15 always worked, okay.

16 Now, our philosophy is, you know, in our
17 part of the country there are premiums. In your
18 part of the country there aren't. I would say
19 that if I could buy the milk and I buy it at
20 what your people are buying it for, that would
21 be huge. I mean that's one way of answering
22 your question.

23 Q Right.

24 A If you have your own producers, there is a
25 certain cost assigned to that, you know. You

1 might have to pay bonuses. I'm talking about
2 now if you're on the farm direct buying. You
3 buy -- you've got volume bonuses, premiums,
4 you've got quality premiums, on and on and on
5 and on. And that's just come on in recent years
6 too.

7 But we feel that if you -- we buy the milk
8 from the people that we do, it just more or less
9 replaces the cost that it would cost us to
10 procure the milk, to service the producer, to --
11 to have the competitive edge that you have to
12 have to get that milk. And being an
13 independent, I can't bring it back into the
14 thing and reblend or do any of those things, you
15 know. We can't do that.

16 Q I understand that. You've been very helpful.
17 Thank you very much.

18 **MR. YALE:** I have no further questions.

19 **JUDGE PALMER:** All right. Mr. Beshore.

20 **EXAMINATION,**

21 **QUESTIONS BY MR. MARVIN BESHORE:**

22 Q Good morning, Mr. Roetlin.

23 A Good morning. How are you.

24 Q My name is Marvin Beshore, and I represent DFA
25 and also Dairylea Cooperative, which is in the

1 northeast, in Syracuse.

2 Is some portion of your -- of your milk
3 supply Grade B or Grade C milk, manufacturing
4 grade milk, some portion of the milk that you
5 process?

6 A Yes.

7 Q At your plant, is it what's termed Grade B or
8 Grade C?

9 A Well, there's -- some portion of it is
10 manufacturing grade, but it's still priced off
11 of the Class III.

12 Q Okay. That was -- that was going to be my
13 question.

14 A Is that your question?

15 Q Okay. So all of the milk supply that you
16 purchase -- by the way, your -- I think this was
17 clarified with maybe Mr. Vetne. Your plant is
18 not a pool plant --

19 A Correct.

20 Q -- under the Order? But all of the milk you
21 purchase, whether it's pool milk or nonpool
22 milk, the price that's negotiated with your
23 suppliers is based on the Federal Order prices?

24 A Correct.

25 Q Okay. Now, I think you also indicated to

1 Mr. Vetne that you report your -- your
2 production to NASS --

3 A Correct.

4 Q -- in barrels. Can you tell us, what's the
5 average moisture content of the barrels you
6 produce?

7 A For us, it's -- I can't give you a specific
8 because I'm not sure Kraft would want me to do
9 that, but it would be -- it would be from 3.2 to
10 3.4 -- or, I'm sorry, 32 to 34 moisture.

11 Q Percent moisture?

12 A Yeah.

13 Q And then the moisture is a specification of your
14 buyer; correct?

15 A That's correct.

16 Q Okay. Now, do you look at the weekly NASS price
17 publications?

18 A Correct.

19 Q Okay. Do you notice -- I mean there's a
20 Minnesota-Wisconsin price that's quoted in those
21 NASS prices, you've noted that?

22 A That's where we go. That's where we get our
23 pricing.

24 Q Okay. Your pricing is based -- although you're
25 in Iowa, it's based off of the Minnesota and

1 Wisconsin prices?

2 A Correct. And we have a new price every Tuesday,
3 I believe it is, something like that, and we're
4 on a weekly cycle. They may have changed that.
5 Maybe that's daily now, but, anyway, it got off
6 of that, and then there is moisture allowance;
7 in other words, the pricing you get -- that
8 you're talking about would be 38 percent
9 moisture; is that correct?

10 Q The prices are standardized I think in the NASS
11 report to some point.

12 A But it's at 38 percent I think.

13 Q It's at 38 percent.

14 A Right. We have a scale that we go by that --
15 they call it moisture allowance, so as we go
16 down on that scale, we get -- we get more per
17 price -- or more per pound.

18 Q And those prices are the prices that Kraft pays
19 you --

20 A Correct.

21 Q -- for your barrels? Okay. Now, you've
22 indicated you have moisture specifications, and
23 you also have other production specifications
24 such as you are not allowed to use whey cream,
25 reprocess the whey cream.

- 1 A Correct.
- 2 Q Okay. Now, when you -- your barrels are more
3 expensive to produce because you have to buy
4 your butterfat off the market rather than reuse
5 some of your own cream; wouldn't you agree?
- 6 A Run that question by me again.
- 7 Q Okay. If you could use -- if you were permitted
8 by your buyer to utilize whey cream in your vat,
9 you would have a lower -- that whey cream is --
10 you've already paid for it.
- 11 A Correct.
- 12 Q Okay. And you would be able to obtain more
13 value for that cream in cheese.
- 14 A That's true.
- 15 Q Okay. So that when your buyer specifies that
16 you are not authorized to use the whey cream in
17 that way because of product quality, are you
18 paying a premium for giving up -- for giving up
19 that opportunity?
- 20 A I don't believe so, no.
- 21 Q Let me just ask you just one general question.
22 Since I represent dairy farmers here and the
23 issues are in part, you know, how much the
24 plants are going to pay farmers for their milk
25 and how that's going to be calculated, and

1 you've -- you've indicated you think that the
2 whey -- because of whey pricing, at least, the
3 formula presently requires you to pay more for
4 your milk than you should have to pay to be
5 profitable; is that fair?

6 A That's sort of fair, yeah.

7 Q Okay. Why isn't the problem that your buyers
8 are paying you too little for your end product
9 rather than you're paying too much to your
10 suppliers? What isn't your profitability
11 problem that you're not being paid enough by,
12 you know, Protient or Bongard's or Kraft or, you
13 know, anyone, rather than you're paying too much
14 for your milk?

15 A Well, the price -- the other solids price, as I
16 indicated to you, is -- when they started
17 putting that into the formula, it definitely
18 showed what that was going to do. In order
19 to -- to process the whey at a more profitable
20 way, obviously we have to spend money for whey
21 operations and upgrade it and, you know, invest
22 moneys and, you know, I don't know -- I don't
23 know what type of formula we need or is
24 required. That's beyond my pay scale, but the
25 pricing they got going into that is -- I mean,

1 you know, it just -- it's unreal as far as our
2 pricing.

3 Now, you know, I don't know where you're
4 going to assess who's the problem or what the
5 problem is, but there's definitely a problem.
6 And I'm not asking for anybody to fix the
7 problem for me, and I don't know if anybody -- I
8 mean I'm not the only one that has the problem,
9 okay. As I talk to my colleagues around the
10 country, they've all got the problem, and their
11 situations are different than mine, but they all
12 have the problem, and they all pretty much
13 indicate the other solids price is definitely
14 one of the things that needs to be looked at.

15 **MR. BESHORE:** Thank you very much.

16 **JUDGE PALMER:** Mr. Rosenbaum.

17 **EXAMINATION,**

18 **QUESTIONS BY MR. STEVEN J. ROSENBAUM:**

19 Q Good morning. I'm Steve Rosenbaum. I represent
20 the International Dairy Foods Association.

21 A You're from where, sir?

22 Q I represent the International Dairy Foods
23 Association, which includes the National Cheese
24 Institute, so we're representing a cheese
25 manufacturer like yourself.

1 On the -- with respect to the -- to the
2 formula, as I'm sure you know, there really are
3 three things built into it on the other solids.
4 One is the question of how much other solids you
5 can produce out of a hundred pounds of milk, you
6 know, what will come off of it. And then the
7 second is what's it going to cost you to make,
8 for example, the whey product. And the third is
9 what price do you get for the product.

10 Do you understand all of those -- those
11 three things are all built into the formula in
12 one way or the other?

13 A Yeah, I understand that.

14 Q Okay. And you talked about -- and my -- I just
15 want to clarify if I understood correctly your
16 testimony. Is it your experience that you are
17 obtaining less than the 5.69 pounds of other
18 solids that the formula assumes that you're
19 producing from 3.5 percent milk? Is that one of
20 your issues?

21 A The question is whether we obtain less than that
22 amount of other solids?

23 It's like one of the attorneys asked me, I
24 mean some of that stays in the cheese, so it's
25 sort of hard -- it would be sort of hard to say

1 where it goes. I mean it's -- some of it stays
2 in the cheese, so therefore -- obviously if
3 you've got -- the Order says what, 5.69 or
4 whatever.

5 Q Right.

6 A If some is staying in the cheese, you're not
7 going to get it on the other side, right. I
8 don't know if I'm answering that correctly or
9 not, but that's --

10 Q All right.

11 A Is that your question?

12 Q All right. Let me move on to the next part, the
13 price part of it. Is one of your issues that
14 you feel like you're obtaining in the
15 marketplace less for your other solids, your
16 whey, for example, than the formula is assuming
17 you're gaining?

18 A I still -- I still don't understand that
19 question. You have to speak a little bit
20 louder.

21 Q All right. I'm sorry. The -- you said one of
22 the problems is the other solids pricing --

23 A Yes.

24 Q -- as assumed in the formula; correct? You're
25 paying a price for milk, the Class III price for

1 milk, is based in part on certain assumptions as
2 to what the value is that a manufacturer can
3 obtain for other solids that are produced;
4 correct?

5 A Yeah.

6 Q And has your experience been that you're not
7 actually able to obtain that price in the
8 marketplace and that's one of the reasons why
9 it's not profitable?

10 A I don't know how I want to answer that. If the
11 other solids price continues to go up, right,
12 that means we have to pay more for that portion
13 of the milk.

14 Q Okay.

15 A And by -- basically I guess the answer to that
16 would be yes. I mean yeah, we have to pay more
17 than we can get out of it.

18 Q All right.

19 A Is that the question?

20 Q Yes, that's the -- I'm trying to see where you
21 see the formula is not currently working.

22 A I see. Yeah.

23 Q I think you've answered that question now. What
24 kind of -- do you have open vats or closed vats?

25 A We have Double OOs. They're closed.

1 Q Okay. Are they horizontal or vertical?

2 A Horizontal.

3 MR. ROSENBAUM: I think that's all I have.

4 Thank you very much.

5 MR. ROETLIN: Thank you.

6 JUDGE PALMER: Mr. -- well, let me get
7 Mr. Smith up. He hasn't had an opportunity yet.
8 You didn't think you were going to be this
9 popular, did you? You didn't know you were
10 going to be this popular.

11 **EXAMINATION,**

12 **QUESTIONS BY MR. DANIEL SMITH:**

13 Q Good morning. My name is Dan Smith. I
14 represent the Maine Dairy Industry Association,
15 which is --

16 A Pardon me?

17 Q The Maine Dairy Industry Association, which
18 represents all the dairy farmers in the state of
19 Maine.

20 I just wanted to ask you a few questions
21 about your premium structure. You've said there
22 were different types of premiums that you pay.
23 Can you just explain that a little bit more
24 between what those types of premiums are?

25 A I don't know the specific amounts, how much --

1 Q No, that's okay.

2 A It's like type, quality premiums, you pay -- you
3 might help me out, see what else there is and I
4 can say yes or no.

5 Q Quantity premiums, do you pay quantity premiums?
6 Volume, volume premium.

7 A I don't believe so. I'm not sure. I'm not sure
8 about that.

9 Q Is there an additional, just an amount above
10 what might be --

11 A Yeah, there is a premium so much per -- per
12 hundred, plus components.

13 Q Plus the components?

14 A Yes.

15 Q And how are the premiums negotiated? Is there a
16 process -- is it every year, do you sit down
17 with farmers every year?

18 A Pretty much. I mean, you know, it's -- yeah,
19 it's -- every year you talk about it, and over
20 the last couple of years we have gotten some
21 relief from our milk suppliers. They all know
22 the problem. When you call them, they know.
23 They understand. They see that number out there
24 too. They see the other solids price out there,
25 and they know.

1 Q So --

2 A So we've gotten some -- some relief on that,
3 yes.

4 Q So in addition to looking to the solids price,
5 do you look to the Class I premiums that are
6 available in the market in -- in calculating
7 that number?

8 A Do we?

9 Q Yeah.

10 A No, we do not.

11 Q So it's just straight up --

12 A Strictly in Class III.

13 Q Class III. Have you had any discussions with
14 suppliers about hauling costs? Have you had to
15 make any adjustments on hauling costs when fuel
16 prices have been going up recently? Has that
17 come up in your --

18 A There are -- some of the suppliers charge
19 surcharges on fuel.

20 Q And have those been adjusted in the last six
21 months or a year?

22 A They're adjusted weekly.

23 Q Weekly. And --

24 A We go through a federal -- a sheet that's
25 published by the DOT.

1 Q Yeah. Any additional discussions beyond that
2 with your suppliers, beyond those weekly
3 discussions, adjustment discussions?

4 A Pretty much -- no.

5 Q That's the adjustment, okay. I just want to ask
6 you one more question, a follow-up to a question
7 Mr. Beshore asked about recovering the cost in
8 the marketplace.

9 If you -- you indicated that your
10 discussions with other processors around the
11 country indicate the problem is -- that you've
12 described is a common problem. Why do you think
13 the market is not responding by increasing your
14 price to you rather than having to recover it in
15 the formula for the price? Why isn't your price
16 able to go up? Why can't you charge more to the
17 market?

18 A The price -- the pricing is -- we go off of the
19 weekly markets on the whey. I'm specifically
20 talking about whey, okay. Cheese would be a
21 daily, the market goes up and somehow the
22 NASS -- I'm not sure how they -- we're on NASS,
23 but it still follows -- follows the CME, and
24 it's just a couple weeks later, I believe, or
25 whatever.

1 But, anyway, on the whey, that price is
2 published weekly, I think it's every Thursday,
3 and there is nothing I can do about that price
4 that's published from the buyers and sellers and
5 mostlies, and I'm not sure where that
6 information comes from. Maybe it's -- maybe
7 some of you can help me out. I don't really
8 know where that --

9 Q You're working off the published price?

10 A Correct.

11 Q And that sets the price.

12 A Yeah.

13 **MR. SMITH:** Thank you.

14 **MR. ROETLIN:** Yes, you're welcome.

15 **JUDGE PALMER:** Are there any other
16 questions? Mr. Beshore, you have another
17 question?

18 **EXAMINATION,**

19 **QUESTIONS BY MR. MARVIN BESHORE:**

20 Q Just one question, Mr. Roetlin. Do you know
21 what percentage of the butterfat that goes into
22 the vat is incorporated in your barrel cheese
23 product, is retained?

24 A That is part of our -- do you know what FDB is?

25 Q No, I don't. Sorry.

1 A Fat on dry basis. That's calculated on a fat on
2 dry basis, so we have -- our butterfat has to be
3 a certain butterfat in cheese, but I'm going to
4 say -- I'm going to come off the top of my head
5 again, 36 1/2 percent fat.

6 Q In your cheese?

7 A Cheese on a dry basis.

8 Q Okay. Now -- but let's say -- so I think you
9 told Mr. Yale, and -- in the vat, your -- it's
10 about 3.8 or 3.9 percent butterfat?

11 A You know, it depends on the time of the year.
12 You know, that's sort of a number you got to
13 chase because it depends on the time of the
14 year. It changes. In our part of the country,
15 we're -- a lot of the -- you get in the spring
16 and they pasture and they whatever, the
17 butterfat is much lower, so.

18 Q Let me ask it another way. For every hundred
19 pounds of butterfat that goes into a vat, do you
20 know how many of those pounds are incorporated
21 in your barrel of cheese?

22 A Well, our -- our fat test on our -- on our milk
23 is about 3.5, 3.6 or whatever, and then we add
24 cream to that and we base how much we put in
25 there based on the butterfat or FDB of the

1 cheese, so we regulate that. If the FDB, say
2 they -- let's say we're allowed to have a 50, 56
3 FDB; well, if you got too much fat in there,
4 that goes too high, and if you got not enough
5 fat, it goes too low, so for us it's something
6 like 200 or 250 pounds of fat we might put into
7 that cheese vat.

8 Q What I'm trying to -- trying to learn, if
9 possible, is do you know -- let me try the other
10 end. Do you know how many pounds of whey cream
11 you have for every vat of cheese you make?

12 A I don't know. I guess we never figure it per
13 whey cream per vat, but I mean it would be very
14 easy to find out. My girls probably do it,
15 divide it out and see what you sell at the end
16 of the day -- or the end of the -- every pickup
17 or per week, per month, whatever. I --

18 Q You don't know that number?

19 A I don't know it here now today.

20 Q Okay.

21 A But we have a number like that, but I don't have
22 it.

23 MR. BESHORE: Okay, thank you.

24 MR. ROETLIN: But --

25 JUDGE PALMER: That's all right. Sir, you

1 don't need to volunteer. He's gotten his
2 answer.

3 How about over there, yes.

4 MR. ROETLIN: I'm going to add something to
5 the --

6 JUDGE PALMER: Oh, if you wish to, go
7 ahead, sir. Add whatever you want to.

8 MR. ROETLIN: I don't necessarily think the
9 fat's the problem. I think the problem is the
10 other solids price. I don't think the protein
11 is the problem. I don't think the fat's the
12 problem. It's the other solids price that's the
13 problem. Until somebody decides to change it
14 or --

15 JUDGE PALMER: Well, now you're going to
16 get some questions from folks from the
17 Government, the people over at that table. Go
18 ahead.

19 **EXAMINATION,**

20 **QUESTIONS BY MS. HEATHER M. PICHELMAN:**

21 Q Good morning. My name is Heather Pichelman.
22 I'm with the USDA's Office of the General
23 Counsel.

24 A Yes, ma'am.

25 Q First of all, on behalf of the Secretary, I just

1 want to thank you for being here today,
2 traveling from Iowa and coming here and
3 testifying. The Secretary really appreciates
4 your willingness to come here, and it was a
5 great benefit that you are here today, so thank
6 you.

7 A I hope it helps.

8 Q Absolutely it helps.

9 Actions under the Federal Milk Order
10 Program are subject to the Regulatory
11 Flexibility Act. The Act seeks to ensure that
12 the regulatory and information collection
13 requirements are tailored to the size and nature
14 of small businesses. The Act defines a dairy
15 products manufacturer as a small business if it
16 has fewer than 500 employees.

17 And I believe from your testimony before,
18 you said, there are --

19 A I have 55, and they probably do as much work as
20 a hundred would do. I mean we're -- we are
21 really, you know -- okay.

22 Q Absolutely. So I guess my question to you is as
23 a small business owner, do you have anything
24 else you would like to tell the Secretary about
25 how the Milk Order Program and specifically

1 these proposals, how they are affecting you,
2 advantages, disadvantages, how is it on a
3 small -- on a small business owner in your
4 opinion, anything else you would like the
5 Secretary to know?

6 A I don't know. I think I've pretty well covered
7 it. I -- I tried to, and what I've told you is
8 from my heart and it's honest. I don't have an
9 attorney to do this. I guess I could have
10 brought one along, but my bottom line doesn't
11 permit it.

12 **JUDGE PALMER:** You picked up a few along
13 the way when you got here.

14 A All I can say, ma'am, is something has to change
15 or people like me are not going to be here, and
16 we're not going to be able to handle the milk.
17 We're going to have dairy farmers who are going
18 to have milk out there, if we don't have plants
19 to put this stuff into, I think that will be an
20 economic problem for the dairy farmers also. I
21 mean we're not all Southwest Cheese or Southwest
22 United States. We're not all California. I'm
23 in the Midwest. Here's where I live, here's
24 where I have my family. It's a small business,
25 we're just trying to survive.

1 And having said that, I'm sure they're
2 great people, I don't have any animosity toward
3 them or anything else, toward the positions
4 they're taking, but it's got to change.

5 That's all I have, ma'am.

6 **MS. PICHELMAN:** Thank you.

7 **JUDGE PALMER:** Any other questions over
8 there? No. Any other questions? Mr. Vetne.

9 **MR. VETNE:** I have some Redirect, might as
10 well have --

11 **MR. YALE:** Redirect?

12 **MR. VETNE:** More Cross.

13 **MR. ROETLIN:** Could I say something to the
14 lady for the USDA?

15 **JUDGE PALMER:** Yes, go ahead, you can do
16 that.

17 **MR. ROETLIN:** I think that if they need to
18 make changes, I don't think that -- let's put it
19 this way. I don't think there's a single person
20 in this room that doesn't know what the problem
21 is, but I'm not sure how many people in this
22 room want to change it.

23 But we need to have a more timely -- you
24 know, for that make allowance, let's go back,
25 the make allowance that we got in March 1st, is

1 that correct, they had a make allowance on
2 cheese and dried whey March 1st? That thing has
3 been in the make for what, a year and a half or
4 something like that.

5 And then when they did do it, it was very
6 small and it wasn't really what was required,
7 but we thank everybody for that, but it's not
8 nearly enough. But they need to do it quicker.
9 They need to be able to -- if they're going to
10 be the boss over this milk, whatever you want --
11 the Federal Orders, they have to be able to
12 change quicker, to be able to make that change
13 that needs to be made. Maybe we go down the
14 road two years from now and the -- and the whey
15 solids -- say they made a change on that, just
16 for an example. Maybe they, with their infinite
17 wisdom, think it needs to be up a little bit.
18 Well, they need to be able to change that. It
19 doesn't -- it can't be just set in stone. It
20 needs to be maybe more flexible and quicker.
21 That's all I have.

22 MS. PICHELMAN: Thank you. And thank you
23 again for being here today.

24 MR. ROETLIN: Thank you.

25 JUDGE PALMER: Mr. Yale, you have a

1 question or so?

2 **EXAMINATION,**

3 **QUESTIONS BY MR. BENJAMIN F. YALE:**

4 Q Yeah, kind of a follow-up on that. Was the --
5 you've indicated the profitability earlier.
6 Were these changes in make allowances enough
7 that came out in March, will that be enough for
8 2007? The changes in the make allowances that
9 came out in March, will that be enough to make
10 it more profitable for you in 2007?

11 A No, I think that the -- I'm just going off the
12 top of my head. I don't have those numbers with
13 me, but --

14 Q Right.

15 A The numbers that I heard that were indicated
16 earlier would have been much more in line with
17 what should have happened than what did happen,
18 and in the time period in between, we have -- I
19 get a publication, what the hell's the name of
20 it, Milkweed, and -- and I read that and I
21 have -- I don't know if Mr., whoever he is, if
22 he's even in here, but it's good entertainment
23 once a month. And there's certain people he
24 definitely doesn't like, but that's okay. He
25 sees it maybe as -- only as a dairy farmer, and,

1 you know what, we're in this together. The
2 dairy farmers, the cheese plant operators, the
3 co-ops, the independents, the large
4 corporations, we're all together. And I don't
5 really see why it can't -- I was a former
6 Marine, you know, I can be pretty -- pretty
7 aggressive and whatever, but, you know, as I've
8 got older, I've gotten a little bit more mellow
9 and maybe try to see the other person's point of
10 view, but.

11 Q I think that comes back to that question that
12 Mr. Beshore asked, that since the dairy farmers
13 have the same financial problems as the plants,
14 the plants have financial problems, maybe the
15 answer is not that you pay less for the milk,
16 which the farmers can't afford, but we find some
17 way to get more money out of the market so that
18 you benefit and the producers.

19 A But in my view, he's already done that. They've
20 done it when they put the whey allowance into
21 the -- into the formula, that's when they done
22 it and that's when they got it, so if you take
23 this thing out of there -- well, let's back that
24 up. The only way that you can get this money
25 back out of this is by spending a huge amount of

1 money for whey operations. And if this price --
2 I'm not real sure about this, we got a lot of
3 smart people in here, maybe they can throw a
4 pencil and a calculator to this real quick, but
5 if you were drying whey, sweet whey, a hundred
6 percent of it, how would that come out?

7 I guess I'm asking you the question instead
8 of you asking me. I don't know how that would
9 come out. Would that come out?

10 Q That was why I was asking some of your questions
11 earlier, we were trying to find that answer. I
12 mean there may be a problem both in getting more
13 money out of the market and there may be a
14 problem in the whey formula.

15 A Well, I don't know.

16 Q And that's a question that we're trying to find
17 out.

18 A I can't change the market. There's a published
19 paper that I go by, and that's what everybody
20 goes by. I mean you even have a hard time
21 trying to contract milk. If I go to my friendly
22 co-op and try to contract milk, he's got to go
23 down there and sign up X number of producers in
24 order to get that contract in so I can buy it at
25 a certain price, and some of those friendly

1 co-ops don't like to do that. They don't want
2 to do that. Okay.

3 Q Okay. Change subjects.

4 A Yes.

5 Q You've been extremely helpful, and eye-opening
6 for us, and, by the way, we may be different
7 sizes and have different issues, but I think a
8 lot of respect for people like yourself and
9 producers in the upper Midwest as well, so.

10 And I think that's part of the challenge,
11 frankly. I mean you talk about the Southwest.
12 There is such a diversity in size and stuff that
13 it's starting to put a strain on how we deal
14 with the system, but that's -- I mean if you
15 have a comment on that --

16 A I've bought a lot of milk out of the Southwest,
17 out of Select, one of the groups you represent;
18 is that right?

19 Q Right, yes. Their UF milk.

20 A Right. But today I couldn't buy that milk
21 because it's not possible to buy that --

22 Q Because of whey?

23 A -- and have them take the other solids or
24 lactose, you might -- not other solids, the
25 lactose and dump it out in a field somewhere.

1 Q I understand that. That's --

2 A It's not possible to do anymore, so I had to
3 spend seven and a half million dollars to put
4 this plant in.

5 Q Right.

6 A And then I got to spend another six or seven
7 million putting in a drier to dry sweet whey.

8 Q Okay. So -- and I appreciate that. I think
9 it's a point well taken.

10 Let me change subjects a second, kind of
11 come at what Marv Beshore, Mr. Beshore asked a
12 little bit ago. Both from producer and the
13 cream you buy, you have a hundred pounds of fat
14 come into the plant. How many pounds of that
15 fat go out in the whey cream, do you know,
16 approximately?

17 A Just let me think a little bit here, okay. The
18 cream is usually about 45 percent when we sell
19 it.

20 Something like maybe -- maybe something
21 like 20,000 pounds a week, maybe, so that would
22 represent maybe \$20,000.

23 Q Okay. But 20,000 pounds of whey goes out, then
24 you receive seven million pounds --

25 A I think I'm doing that right, okay.

1 Q So out of the seven million pounds of milk you
2 receive and the cream, about 20 million pounds
3 go out as whey cream -- or 20,000 pounds go out
4 as whey cream?

5 A Twenty thousand a week, so it'd be -- I'm not
6 sure. I'm not sure I did that right.

7 **JUDGE PALMER:** That's all right. This is
8 not a math exam. Let's --

9 **MR. YALE:** I appreciate that. And I don't
10 have any other questions. Thank you.

11 A But --

12 Q Yes.

13 A I want to reiterate here --

14 Q The fat's not the problem.

15 A -- butterfat's not the problem.

16 Q I understand that, but that's another issue --

17 A Protein's not the problem.

18 Q The other solids.

19 A Cost of milk; you know, it's the other solids
20 driving up the cost of milk.

21 Q Right. Very good.

22 A I think we all know that.

23 **MR. YALE:** Okay. Thank you.

24 **JUDGE PALMER:** You are now excused -- oh,
25 you want to ask some more questions. I have to

1 take a break, but. Are you okay up there? Are
2 you okay?

3 MR. ROETLIN: Oh, I'm fine.

4 JUDGE PALMER: And the reporter's okay.
5 All right. Come on up, Mr. Vetne.

6 EXAMINATION,

7 QUESTIONS BY MR. JOHN H. VETNE:

8 Q Sir --

9 A Yes, sir.

10 Q -- you indicated that protein is not the
11 problem, butterfat is not the problem. Some of
12 the proposals here would increase prices,
13 regulated prices, costs for fat and protein.

14 A Did you say some of the proposals would increase
15 or decrease?

16 Q They would increase.

17 A The price of?

18 Q The price of milk that you -- the price of
19 protein you use in cheese and the price of fat
20 that you use in cheese.

21 A Correct. From what I saw, somebody's proposal
22 was like -- just see if we're on the same page
23 here. You're saying like 1 -- I think Select or
24 this gentleman has 1.20 or 1.21; is that what
25 you're saying, it would go -- they would --

1 **JUDGE PALMER:** Stay with Mr. Vetne.

2 A -- they would go with that 1.12.

3 Q Let me ask it this way. Some of the proposals
4 here, when it ends up in the final formula,
5 whether it's other solids or protein or anything
6 else, would increase the price, the Class III
7 price, by 20, 25 cents.

8 A Yes, which would take away the make allowance we
9 just got.

10 Q It would put you back to where you were before.

11 A Exactly.

12 Q But it doesn't really matter to you whether it's
13 in the other solids or the protein. If you're
14 paying more for milk and not getting more for
15 the cheese that you sell, it squeezes your
16 margins.

17 A It's -- I mean -- and maybe I didn't -- maybe I
18 was not clear on what I said, that it doesn't
19 matter. Of course it matters. Everything
20 matters.

21 Q So when you say that protein is not the problem,
22 would you agree that it would be a problem if
23 your protein price were increased?

24 A Yeah, I -- absolutely, but I mean I guess I was
25 thinking in the -- in the mind that what we

1 currently have right now as far as protein and
2 butterfat, but if it was increased, of course it
3 would impact, yeah. That's not what I meant
4 when I said that.

5 Q Okay. You indicated to Mr. Yale that you sell
6 about 20,000 pounds of whey cream per week?

7 A I said that, but I'm not sure.

8 Q You're not sure. But you receive about a
9 million pounds of milk per day?

10 A Correct.

11 Q So that's 20,000 pounds of whey cream from
12 receipt of seven million pounds of milk?

13 A Roughly.

14 Q Plus the cream that you buy.

15 A Correct. Somebody put a pencil to that and then
16 call me up and tell me how bad I'm doing here.
17 Okay.

18 **MR. BESHORE:** I already did.

19 Q When you buy milk, you indicated that you buy
20 Grade A milk and Grade B milk, you pay the same
21 price for that milk.

22 A Correct.

23 Q Do you know what portion is Grade A and Grade B?

24 A It's primarily Grade A.

25 Q It's primarily Grade A?

- 1 A There's not much Grade B left, yeah.
- 2 Q But the Grade B portion is not designated
3 separately?
- 4 A No, it's all the same, classed off of Class III.
- 5 Q And it's all commingled, you don't know what
6 portion is which?
- 7 A Exactly.
- 8 Q And when you sell cheese, you indicated that you
9 have been selling at a new price every week, and
10 it might be every day. Is your cheese based off
11 the CME?
- 12 A Okay, I thought about that after I said that.
13 We have -- we have a price given to us every
14 Tuesday -- we have a price given to us every
15 Friday that will involve all the cheese from
16 Tuesday to the previous Friday for that whole
17 seven days, and it is averaged out on a per CME
18 pricing every day and is averaged out for a
19 whole week.
- 20 Q So it's --
- 21 A You understand what I'm saying?
- 22 Q So it's a CME weekly average?
- 23 A CME weekly average, correct.
- 24 Q Applied retroactively by week.
- 25 A Correct.

1 Q Do you know whether that same price formula is
2 applied to other suppliers of barrel cheese to
3 Kraft or is that only for you?

4 A I would assume so.

5 Q So if you wanted more for your cheese and Kraft
6 didn't want to pay more, it would just go
7 someplace else?

8 A Well, basically that would be it, but, yeah.

9 Q When you make cheese, do you sometimes produce a
10 barrel that doesn't meet Kraft's specifications,
11 that is off grade?

12 A I can remember one time, seriously, one time
13 in -- since I've completely owned it myself in
14 '85 that we had a cheese that we had to sell to
15 C -- MCT, I don't know who they are, from out
16 East somewhere, and he wasn't very happy because
17 it wasn't quite as good as he thought it was,
18 but, anyway, I told him it wasn't good, but,
19 anyway, only one time.

20 Q Okay.

21 A So our quality control is excellent. We sell to
22 Kraft. I don't know what anybody's affiliation
23 is here with cheese or whatever, but these
24 people are pretty meticulous. They want it a
25 certain way and that's the way they get it, and

1 we give it to them that way.

2 One of my employees one day, we made a
3 change and he got really upset. He said well,
4 why do we have to do this. I said don't even
5 ask me why we have to do it. I said if they
6 want it green, that's the way we'll give it to
7 them. That's all. I mean, and, like I said,
8 the list of people we sell whey to, and we
9 got -- if we had the whey, we could sell a lot
10 more of it. But I -- it's priced off of that
11 market that comes out every Thursday.

12 Q Where do you sell your dry lactose? Where do
13 you sell your dry lactose? To the same buyers?

14 A We don't have any dry lactose. I make -- I make
15 whey protein concentrate 55 and I make -- and
16 out of -- the end product out of that is
17 permeate, which is based off the lactose market.
18 It's about 45 percent solids. It's liquid.

19 Q What do you do with that permeate?

20 A We sell it to Protient is one of the people;
21 Land O'Lakes is another one.

22 Q You sell it in liquid form?

23 A In liquid form, correct. If we got a little
24 extra money, we would put a drier up and dry it.
25 In about a year from now we can do that.

1 Q All right. Having made -- having been -- you've
2 been in the black two years in the past six full
3 years.

4 A I said since --

5 Q Since 2000?

6 A -- 2000.

7 Q So that's six accounting years for you?

8 A Correct -- seven.

9 Q Seven accounting years for you. Okay. If that
10 is your projection for the future, will you stay
11 in business long term?

12 A I hope so.

13 Q How would you stay in business if you're --

14 A Well, that's one of the reasons I'm here, number
15 one. Number two, we have a very good banker.
16 We're not late with any of our payments ever.
17 We intend to be -- and some of my personal
18 assets have went into this, to finance this, to
19 pay for what we have to pay for.

20 Q If your price goes up --

21 A It's not coming out of the cheese plant, that's
22 what I'm telling you.

23 Q Okay.

24 A And it's not a hobby, either.

25 Q If your cost -- the price went up by 25 cents

1 back to where you were before and you told your
2 banker that, would that affect your ability to
3 borrow money to make improvements?

4 A He probably wouldn't be very happy.

5 Q Would that affect your ability to borrow money
6 to make improvements?

7 A I would think it would. Eventually it's going
8 to. You know, anybody can see if you continue
9 to do this, eventually -- it eventually would
10 cause you a problem borrowing money.

11 Q And the farms that ship to you you say come from
12 your area.

13 A Yes.

14 Q If they weren't shipping to you, how far would
15 they have to take their milk to find a
16 manufacturing home, or any kind of home for the
17 milk? How much further?

18 A I would say quite a ways. I don't have -- I
19 don't have the ability to answer that, but it
20 would cost somebody. It would be -- DFA or
21 Swiss Valley or somebody, it would cost them
22 additional money to get it to other locations.
23 Well, that would just come off the producer. I
24 mean it's like they would be -- it would cost
25 them more, but I don't know what that would be.

- 1 Q Paid by the farmer?
- 2 A I just --
- 3 Q Be paid by the farmer, the producer?
- 4 A Well, sure, it would be.
- 5 Q Finally, you indicated that some of your raw
6 ingredient is subject to a fuel surcharge.
- 7 A Yes.
- 8 Q And that's a fuel surcharge that's indexed off
9 of some government --
- 10 A Yes.
- 11 Q -- publication of fuel costs?
- 12 A Yes, the DOT listing that comes out weekly, I
13 think, if anybody's familiar with that.
- 14 Q Department of Transportation?
- 15 A Yes. We get it -- we get it -- we subscribe to
16 whatever it is, it comes in the --
- 17 Q Do you know what product is being indexed,
18 diesel fuel or --
- 19 A Diesel fuel.
- 20 MR. VETNE: Okay. Thank you.
- 21 MR. ROETLIN: You're welcome.
- 22 JUDGE PALMER: Yes. I hope it's truly
23 relevant. Go ahead. Not repetitive.
- 24
- 25

1 **EXAMINATION,**

2 **QUESTIONS BY MR. MARVIN BESHORE:**

3 Q Just a follow-up to that question on energy
4 indexes. You've talked about make allowances
5 and the slowness for updating make allowances.

6 One of the proposals in this hearing would
7 put an energy index in your make allowance so
8 that when your cost of natural gas or diesel
9 fuel or fuel oil in your operations went up,
10 your make allowance would go up with the
11 publication by government sources of those
12 changes. Would you favor that?

13 A If I understand the question correctly, I think
14 I would. If I understand your question
15 correctly, if the price of energy, utilities, is
16 that what you're saying?

17 Q Yes.

18 A I don't know how they would pick those numbers
19 out.

20 Q Natural gas and electricity.

21 A If that goes up and our make allowance goes up?

22 Q Yes. Just as your fuel adjuster works
23 presently, the fuel surcharge works on products
24 you're purchasing, your make allowance would be
25 adjusted with those indexes in the same manner.

1 A I think so.

2 Q It would help the lag issue, wouldn't it?

3 A Yeah.

4 MR. BESHORE: Okay. Thank you.

5 JUDGE PALMER: Thank you very much, sir.

6 Thank you for coming down, and we're going to
7 let you go now. We appreciate your testimony.

8 MR. ROETLIN: Thank you.

9 JUDGE PALMER: Thank you. We're going to
10 take a short recess now for five minutes, and
11 we'll go off the record.

12 *(At this time a recess was taken.)*

13 ROBERT D. WELLINGTON,

14 having been first duly sworn in by the Judge,
15 was examined and testified under oath as
16 follows:

17 JUDGE PALMER: All right, Mr. Vetne,
18 Mr. Wellington is sworn.

19 MR. VETNE: John Vetne representing
20 Agri-Mark and others.

21 Bob Wellington's statement in virtually
22 complete form, there may have been an edit or
23 two, was posted on the Internet so you could
24 have it in advance, and this version with the
25 complete tables was distributed yesterday.

1 Is there anybody that needs a copy that
2 didn't get one? Okay.

3 **JUDGE PALMER:** Meanwhile, we're marking it
4 as Exhibit No. 35.

5 *(Thereupon, Exhibit No. 35 was marked for*
6 *purposes of identification.)*

7 **MR. VETNE:** Okay, Mr. Wellington, you have
8 previously addressed other issues, and you now
9 wish to provide affirmative proponent testimony
10 on Proposal No. 14?

11 **MR. WELLINGTON:** Yes.

12 **MR. VETNE:** You may proceed.

13 **TESTIMONY OF ROBERT D. WELLINGTON**

14 **MR. WELLINGTON:** Okay. My name is
15 Robert D. Wellington. I testified during the
16 first week of this hearing on Proposals 1, 2, 10
17 and 11, and now wish to do so regarding
18 Agri-Mark Proposal 14.

19 Proposal 14.

20 This proposal seeks to amend the Class III
21 and Class I product pricing formulas by using a
22 combination of the weekly NASS (National
23 Agricultural Statistical Service) and CME
24 (Chicago Mercantile Exchange) cheese price
25 series to determine the cheese price to be used

1 in the Class III and Class I product price
2 formulas.

3 CME versus NASS Cheese Prices.

4 U.S. cheese manufacturers use the CME
5 market prices as a basis to set the cheese
6 prices they charge in the marketplace. In
7 addition, California uses the CME price series
8 to set its state mandated milk price for milk
9 used to make cheese (Class 4b). However, USDA
10 uses a different price series in its price
11 determination.

12 USDA uses the NASS cheese price survey to
13 determine the cheese prices that, in turn, are
14 used to determine the Class III prices each
15 month. While the NASS and CME are closely
16 linked, that relationship usually involves a
17 two-week lag.

18 The two-week lag between NASS and CME
19 prices became a serious problem in 2004 when CME
20 cheese prices changed so quickly from week to
21 week that the monthly average between the two
22 price series fluctuated dramatically. In fact,
23 the two prices varied by more than ten cents per
24 pound in seven of the twelve months of 2004.

25 Figure 1, which is at the back of my

1 statement -- in fact, I would add, offer my
2 testimony, there's two figures at the back of
3 the testimony I handed out, I put them at the
4 back because they're both in color, I think it's
5 easier to understand them. One is labeled
6 Figure 1 and the other one is labeled Figure 2A,
7 as well as Figure 2B.

8 Returning back to my prepared statement.

9 Figure 1 provides a graphic representation
10 of the differences in CME versus NASS weighted
11 average cheese prices shown in red and the
12 differences in CME versus Proposal 14 weighted
13 average cheese prices, and I'm inserting in
14 black, on a monthly basis from 2003 through
15 2006. The intent of Proposal 14 is to reduce
16 those differences while still using the NASS
17 price series as the primary indicator of cheese
18 price changes. The data shown in Figure 1 is
19 also given in Appendix Table 1.

20 Relationship Between the NASS and CME
21 Cheese Price Series.

22 The following table shows the simple
23 regression results estimating the relationship
24 between the NASS and the CME for block and
25 barrel cheese price series. The table shows the

1 relationships based on having no lag, as well as
2 one-week, two-week and three-week lags. The
3 time period considered is from January 2000,
4 when the Orders were amended to use NASS
5 pricing, to February 2007. Specifically, there
6 are 372 weeks going from January 22, 2000,
7 through February 24, 2007. The initial weeks of
8 January 2000 were not included in the direct
9 regression analysis due to the assumption of a
10 three-week lag as one of the scenarios.

11 As seen in Table 1, a two-week lag in the
12 CME relative to NASS prices shows the best
13 relationship. In fact, during the last seven
14 years, the CME price series accounted for
15 between 97 percent and 98 percent of the
16 variation in the NASS price series.

17 And that Table 1 is as written.

18 How Proposal 14 Works.

19 Figures 2A and 2B show the weekly timeline
20 for the monthly cheese price used in the Class
21 III and Class I price calculations of Proposal
22 14. Using the month of April as an example,
23 Figure 2A shows the NASS cheese prices for the
24 four weeks of April that are used to calculate
25 the Class III price -- Class III price for the

1 month. While the April NASS prices are
2 correlated with the CME price for the last two
3 weeks of March and the first two weeks of April,
4 there is no adjustment in the price formulas
5 currently done to relate the two.

6 Underneath the current April Class III
7 pricing line -- timeline in Figure 2A is an
8 alternative timeline showing the weeks to be
9 used in Proposal 14 that links the cheese price
10 used to calculate the Class III price (referred
11 to as "the Class III cheese price") with the CME
12 market prices. The proposal uses the actual CME
13 weekly prices for the four weeks of April
14 adjusted by the difference between the NASS
15 cheese prices (for the last two weeks of March
16 and the first two weeks of April) and the
17 previous month's CME cheese prices (the four
18 weeks of March in this example).

19 The Class III cheese price setting
20 mechanism of Proposal 14 uses all the weekly
21 observations of all NASS and CME prices. Over a
22 number of months, the CME current month price
23 series and the previous month CME price series
24 cancel one another out, leaving only the NASS
25 price series as the average price indicator over

1 time. This proposal allows the USDA to use
2 up-to-date CME prices needed by the industry
3 while making the appropriate adjustments in
4 those prices to assure that the NASS price is
5 the primary determinant of cheese prices over
6 time. If the CME price is manipulated in such a
7 way as to diverge from the true NASS prices,
8 this proposal adjusts those CME prices to the
9 actual NASS prices to correct the situation.

10 The timeline chart in Figure 2B shows how
11 the cheese prices for the Class I price
12 determination can also be adjusted in order to
13 use the more current CME price series, while
14 also maintaining a relationship to NASS prices.
15 This part of the proposal allows the use of
16 actual CME prices for the second and third weeks
17 of March to determine the Class I price -- Class
18 I cheese price instead of the current first two
19 weeks of NASS pricing. This part of the
20 proposal does use a different set of weeks than
21 currently used, so it may not come back entirely
22 to the NASS pricing on a historical basis.
23 However, it does relate back to the NASS price
24 series.

25 Impact On Federal Order Prices.

1 Appendix Tables 2 through 5 show the
2 detailed monthly changes in the cheese prices
3 used in the Class I and III formulas, the
4 changes in the Class I and III prices, the
5 changes in the Northeast Order producer price
6 differentials and the Northeast uniform prices,
7 and changes in the protein price.

8 Table 2 contains a summary of those
9 appendix tables showing the average of the
10 annual and four-year cumulative time periods
11 (2003 to 2006). While the annual averages under
12 Proposal 14 can differ from year to year, the
13 four-year cumulative average for all prices were
14 less than a half a cent per pound of cheese --
15 I'm sorry, the four-year cumulative average
16 difference was less than a half a pound of
17 cheese or less than two cents per hundredweight
18 of milk for all prices.

19 The Proposal 14 is not intended to increase
20 or decrease any prices used or determined by
21 Federal Orders. The intent is to reduce the
22 monthly differences between the prices that most
23 cheese manufacturers sell their product for and
24 the cheese prices used to determine their cost
25 of milk. In this process, the proposal also

1 reduces the number of weeks it takes to transmit
2 marketplace cheese prices into changes in farm
3 milk prices.

4 Next in the statement is Table 2.

5 And then at the end of the statement, the
6 last paragraph is: Originally I had hoped that
7 this proposal would also lessen the occurrence
8 of negative producer price differences, which
9 are mostly a by-product of the time lag between
10 Class III and Class I price changes. This was
11 indeed the case when the Class I cheese pricing
12 changes (shown in Figure 2B) were considered
13 independently of the Class III price changes.
14 However, when both changes were considered at
15 the same time, as is being proposed, the lags
16 are reduced for both the Class I and III prices,
17 but the lag relative to each price series is not
18 reduced. This is why Appendix Table 4 does not
19 show any reduction in the negative PPDs for
20 2004.

21 Thank you for this opportunity to present
22 Proposal 14.

23 **JUDGE PALMER:** Mr. Vetne.
24
25

1 DIRECT EXAMINATION,

2 QUESTIONS BY MR. JOHN H. VETNE:

3 Q Mr. Wellington, with respect to Proposal 14, do
4 you have any additional comments that you did
5 not include in your prepared statement?

6 A In regard to just this proposal?

7 Q Just that proposal.

8 A Not in -- not in regard to Proposal 14.

9 MR. VETNE: Your Honor, Mr. Wellington, his
10 cooperative is having their annual meeting this
11 week; in fact, it's going on right now in his
12 absence and he's going back today. I have some
13 additional Direct testimony, a few comments on
14 some other things, but in order to keep things
15 clean in the record, Testimony on Proposal 14,
16 Cross on Proposal 14, I will ask that when --
17 those questions when the Cross on 14 is over.

18 JUDGE PALMER: Okay. I understand. So
19 this is on Proposal 14 only, although he's going
20 to testify on some other matters after that's
21 complete.

22 Do we have questions for him on 14?

23 Mr. Yale.

24

25

1 CROSS-EXAMINATION,

2 QUESTIONS BY MR. BENJAMIN F. YALE:

3 Q Good morning.

4 A Good morning.

5 Q I'm going to ask you a question about the
6 pricing of cheese. What is the reference price
7 at which most cheese in the United States is
8 sold?

9 A The Chicago Mercantile Exchange, to the best of
10 my knowledge.

11 Q And the cheese -- even if it's not cheddar
12 cheese?

13 A My understanding is it's for all the basic
14 cheese varieties. It is for our cheese
15 varieties and it also is for all our types of
16 cheese varieties, although mostly what we do is
17 cheddar.

18 Q And that is the CME price plus or minus some
19 basis?

20 A That's correct.

21 Q All right. Now, when you -- there's no future
22 cheese market, right, futures cheese market?

23 A No, not -- there's a Class III, but not on
24 cheese.

25 Q Right. So when you contract to sell cheese,

1 say -- let's say that you and I entered -- I'm
2 going to buy some cheese and we're going to
3 price it for when it -- it's going to be made
4 and I'm going to take it in September. How do
5 we reference, how do we price that?

6 A Usually in our case, it's the price -- the CME
7 price when the cheese is made, plus or minus
8 ascribed for difference.

9 Q So that's what's called the vat price sometimes,
10 right, or priced at the vat?

11 A We don't use that term, so I -- but it sounds
12 like it would be appropriate.

13 Q All right. So the concept is is that you and I
14 have agreed that whatever the market price for
15 cheese is in September, whatever that is, we've
16 agreed to have the transaction and all we're
17 going to do is adjust whatever the value for
18 your variety and your quality and location and
19 other factors will add or subtract the basis off
20 that?

21 A That's generally the case. I mean if there was
22 some other circumstances, we would try to
23 negotiate the plus or minus, we would try to do
24 that, although that's always difficult to do.

25 Q Right. I'm not arguing whether you'd get more

1 or less. The point of it is -- and that's
2 commonly done throughout the cheese industry, to
3 your understanding?

4 A Well, it is, and, in fact, that's the -- the
5 purpose of my testimony here shows that the NASS
6 prices are very closely correlated to the CME
7 also.

8 Q Right. So what we have, then, is without the
9 futures market is that the price risk between
10 the buyer and seller of the cheese has been
11 offset because they've all agreed that it's
12 going to be the market price at the time the
13 cheese is made; right?

14 A On the cheese side.

15 Q The futures side. I mean selling the cheese,
16 the buyer and the seller of the cheese don't
17 have any price risk in terms of whether they're
18 going to be under or below the market because
19 they've agreed they're going to tie themselves
20 to the market at the time the cheese is made.

21 A Basically, yes. Yes.

22 Q All right.

23 A I mean there is risk in terms of the make
24 allowance and --

25 Q Right, right. No, I understand that.

1 A We're just saying that --

2 Q Now let's talk about from the cheese plant's
3 standpoint is is that there's a market risk to
4 them that their raw product costs may be more or
5 less than what it would be to make the cheese,
6 sell it at the CME price plus or minus the
7 agreed basis; right?

8 A Yes, plus it's not -- when you make cheese, you
9 don't just make cheese, as you know, we make
10 whey products, and that creates another set of
11 problems.

12 Q Another set of problems. But in a volatile
13 market, one in which prices move up and down
14 rapidly, the two-week lag between the NASS
15 reporting and the CME creates a risk to the
16 plant that although they've agreed to sell the
17 cheese at that reference price, their raw
18 product price is going to be based upon
19 something several weeks old?

20 A Right. Plus, if you look at the average price
21 that they pay for the milk, it's the average
22 over the month, and hence if you look at Figure
23 1, you'll see that there's a tremendous
24 difference between the CME and NASS prices, even
25 though they average closely over time, you know,

1 I believe I said seven out of ten months -- or
2 out of twelve months had price differences in
3 excess -- what'd I say, I think it's ten cents
4 at least, and so that does create some
5 accounting problems and sales problems, and
6 that's really why we presented this proposal.

7 Q Now -- but that's a -- the assumption is -- with
8 the NASS is you're producing the same volume of
9 cheese throughout the month and buying the same
10 volume of milk, that's the only way that that
11 average can really work to your costs; right?

12 A Well, when they calculate the NASS, they do put
13 the weekly --

14 Q They weight it.

15 A They weight it and they put the weekly volumes
16 or whatever, but when we're looking at what our
17 costs are, we're looking at the monthly costs.

18 Q Right, but now -- and you would agree, then,
19 would you not, that there is a risk in the
20 selling of cheese at the vat price or at the
21 making the price, that the cheese plant has the
22 risk that they don't know what their raw product
23 supply is going to be for that milk, plus the
24 other risk you talk about, the whey, but I don't
25 want to talk about that, I just want to talk

1 about the --

2 A That's correct.

3 Q All right. When you negotiate prices for the
4 sale of cheese, do you consider that risk in
5 establishing your basis?

6 A Well, we would like to, but it depends on if --
7 if we go to our customer and say well, we need
8 this much more for our cheese, if the customer
9 says no, I can get the cheese elsewhere, then --
10 then we can't get it. If we can't get it, we
11 can't get it. We would like to cover all our
12 risk.

13 Q Well, do you have a situation, though, where you
14 may have the possibility -- I know as a co-op
15 it's a little more difficult, or may be easier.
16 Do you see a tendency in some cases maybe where
17 you sell milk to people who make cheese where
18 they try to -- the plants try to offset that
19 risk by reducing what they pay their producers
20 so that they've got themselves a kind of a
21 hedge?

22 A Well, I mean we did have quite a bit of
23 push-back from the cheese manufacturers who we
24 sell milk to to make cheese because of all these
25 factors on the Class III price, and so our

1 premiums did have to go down because we have
2 all -- when they came to us and said you
3 understand our problem, we of course understood
4 their problem, we were having the same problem,
5 so we tried to react.

6 I mean, you know, which piece of the
7 equation of the value of cheese versus the value
8 of the raw product creates the problem is almost
9 irrelevant when there's a problem, and they just
10 want -- they just want to correct the problem.
11 And, of course, we couldn't -- we couldn't
12 correct the problem for them even with premiums
13 and the like. We could, you know, address them
14 to some degree, but it still wasn't enough to
15 solve the problem for us or them.

16 Q But the more of the risk that we remove from the
17 system, that does improve the efficiency and
18 hopefully the value of both the cheese and the
19 raw milk; right?

20 A Usually costs -- risk is associated with
21 increased costs.

22 Q Now, in your Direct -- or not -- yeah, I mean in
23 the testimony you've had over both this hearing
24 and hearings -- particularly when we had the
25 make allowance hearings last year, there was a

1 lot of talk about the fact that the use of the
2 NASS also created a degree of circularity in the
3 pricing in the sense that if you raised the
4 price of cheese, you were able to negotiate, for
5 example, with your plants and obtain another
6 half a cent a pound on your basis per pound,
7 that that would then be reported to the NASS;
8 okay?

9 A Right.

10 Q And then if the whole market was able to do
11 that, the NASS would come back and force you to
12 take that money that you got in the extra price
13 for the cheese and pay it back to the producers
14 and in the end the plant didn't gain from that
15 extra sales price.

16 A That's true. For example, the previous witness
17 said that his numbers are reported to the NASS,
18 and so the question was asked could you go back
19 to, I guess his customer was Kraft, and get a
20 higher price, and he explained the difficulty in
21 doing that, but if he did do that, he would then
22 be reporting that higher number to the NASS
23 again.

24 Q So your proposal I think responds to a
25 legitimate concern about the price risk and

1 being able to line up what the plants pay for
2 the milk for the day they sell the cheese
3 because of the industry that we're in, but it
4 doesn't address the issue of the circularity,
5 does it?

6 A No.

7 Q Now, why -- if we're going to try to adjust to
8 the CME, why not just use the CME, or do like
9 California where CME -- it's CME minus and they
10 adjust this number from time to time based upon
11 what sales are actually at and use that as the
12 basis rather than going through the mechanism
13 that you have?

14 A Well, we considered that, and many of our
15 manufacturing people asked that same question.
16 And I had initially had discussions with the
17 Department on this several years ago. Before we
18 were into the hearing process, we were talking
19 about how do we address this problem informally
20 and what kind of proposal might be appropriate.
21 And based upon what they wrote in the decision
22 back in the late 1990s when they determined to
23 use the NASS pricing, I got the impression they
24 felt very strongly about using the NASS, and in
25 subsequent conversations two years ago, I

1 continued to get that feeling, that NASS is very
2 important to them.

3 Also when I talk to producer groups, they
4 are very concerned about the CME being
5 manipulated because it's much smaller volume
6 market than the NASS, and so there's some
7 comfort level of having so many millions of
8 pounds on a weekly basis with the NASS, so I
9 felt at that time that it wasn't going to be a
10 successful proposal to use the CME, and so
11 therefore I was going to have to keep the NASS
12 as part of the equation, but also try to return
13 the price to the CME, hence this sort of hybrid
14 price that we came to, but I believe there is
15 some value to the NASS in that the CME is a
16 relatively small volume market, and when
17 you're -- under the NASS you're selling a lot
18 more products, and usually when you're selling
19 products in marketing products, you're giving
20 some kind of volume discount, and NASS might
21 reflect a volume discount, for example, that CME
22 doesn't. That's why usually the NASS prices are
23 slightly below the CME. Now, that's my
24 hypothesis.

25 We don't -- we do sell some product at the

1 CME price, or I think we even sell at a slightly
2 bit under, that's very generic product. We
3 don't report it to the NASS because we don't
4 have a large amount, we don't have it on a
5 regular basis, but we do relate to it somewhat,
6 but the volumes are such that there's not really
7 a volume discount, but perhaps if Mary Ledman
8 was here, she might be able to explain some of
9 that further.

10 Q So one of the issues I think you point out is
11 that there's a perception by producers and
12 others that the CME, I think the expression is
13 that it's too thin or something like that;
14 right?

15 A That's what I've heard.

16 Q But what we have found by your own statement and
17 exhibits there is that the NASS basically proves
18 that the CME is what the market is; right?

19 A Essentially, yes.

20 Q So the -- the alternative to deal with that,
21 then, would be is not so much to abandon NASS in
22 terms of the collection and the reporting of the
23 data, but to not use it fully into the formula
24 and as a result you begin to have the benefits
25 of using the CME as your pricing mechanism, but

1 you can use the NASS to provide the sense of
2 security and confidence to the rest of the
3 industry that in fact that does reflect what the
4 market is doing.

5 A That's true, but if you're getting to the point
6 of will it reduce the circularity, I'm not
7 convinced it will do that either, but your
8 statement I believe is true.

9 Q Well, the -- if you use the CME and you're not
10 incorporating the basis and people change their
11 basis to increase their margins at the plants,
12 the NASS captures the basis where the CME does
13 not; right?

14 A Yeah, but everybody -- you're seeing this
15 incredibly close link between the CME and the
16 NASS, and if -- if, for example, we try to
17 increase our price relative to the CME to maybe
18 get beyond some of these circularities, okay,
19 that's the most difficult negotiation we have
20 because they'll say well, no, I want -- this is
21 what our price is, it's the CME. I'd give you
22 more for your cheese if the CME goes up, okay,
23 but everything is relative to the CME, so it
24 builds -- that circularity tie is built right
25 back in. That's one of our problems, so I don't

1 think -- I don't think we get away with it just
2 by -- away from it just by going to the CME
3 versus the -- from the NASS.

4 Q Does Agri-Mark participate in the CME market,
5 cash market?

6 A No, not that I'm -- I don't believe we -- on
7 cheese, no, not that I'm aware of. On butter,
8 we might have on a very, very rare occasion in
9 the past, but not generally, no.

10 MR. YALE: Very good. I have nothing
11 further.

12 JUDGE PALMER: Questions? Mr. Beshore.

13 **CROSS-EXAMINATION,**

14 **QUESTIONS BY MR. MARVIN BESHORE:**

15 Q Bob, can you tell me in -- I hope I didn't just
16 miss this in your testimony, but can you tell me
17 how you -- in your tables how you weighted the
18 CME to make it comparable to the NASS?

19 A I was afraid someone was going to ask that
20 question.

21 Q So it's not in your testimony, I didn't miss it?

22 A Well, no, you didn't miss it. It's not in my
23 testimony. In fact, I was thinking about that
24 too because when I -- when I did all these
25 calculations and all -- you know, all the

1 appendix tables, this looks like a lot of
2 information, but it's really straightforward
3 just calculation; you plug in new cheese prices
4 and you generate all the formulas that generate
5 these prices, okay.

6 But when I used the last CME -- or,
7 actually, when I'm using the current CME, I need
8 a volume to do it, and so what I ended up doing
9 was I used that current week's NASS volume for
10 that weight, okay, but in reality -- and I
11 thought the question would probably come from
12 the Department, would be well, you don't have
13 that information, okay, and that's true, we
14 don't have that information, so in retrospect I
15 looked at it and said well, you can use the NASS
16 price from one month ago -- I'm sorry, the NASS
17 volume from one month ago as the volumes, but in
18 my -- in my analysis I did weight by the weekly
19 volumes, but what I did was whatever week I had
20 a price for, I used the NASS volumes for both
21 the CME and the NASS because that's the only
22 volumes I had.

23 Q Okay. Now --

24 A Did that answer your question, Marvin?

25 Q I think so. They're weighted by volume the same

1 way?

2 A Yes, they're all weighted by volume, although
3 there was an issue with the timing.

4 Q And how did you make your CME prices and NASS
5 prices comparable in the sense of NASS reports
6 for barrels two prices. There's only one CME
7 price.

8 A I used the NASS price that's per barrel that's
9 used in the Federal Order pricing.

10 Q Which is the -- the moisture adjusted price?

11 A Yes. Yes. I just used that same NASS price.

12 Q And is it your understanding that the NASS
13 barrel price is a moisture adjusted price?

14 A The NASS barrel price is --

15 Q I'm sorry, the CME barrel.

16 A CME. Well, actually that's a good point. We
17 don't deal with barrels, so I did jump to that
18 assumption.

19 Q Okay. So you were comparing the published CME
20 barrel price with the moisture adjusted 38
21 percent barrel price at NASS?

22 A Yes.

23 Q Okay. So you don't deal with barrels. Is there
24 any barrel production in the Northeast or
25 New England, very much?

1 A Most of the -- the cheddar plants I'm aware of
2 make block, but there could be, but I'm not
3 aware of it. I couldn't say no because I don't
4 know.

5 Q It's limited, if any --

6 A I would believe so.

7 Q -- in your part of the country. Are there any
8 new barrel plants under construction?

9 A In the Northeast?

10 Q In the Northeast.

11 A No.

12 Q Are you familiar with the term block/barrel
13 spread?

14 A Yes.

15 Q What does it mean?

16 A The difference between the block and the barrel
17 pricing. Is that what you're referring to?

18 Q I'm just asking for the -- you know, your
19 understanding of that terminology. I mean it's
20 something that people use in the industry,
21 right, just the -- that terminology,
22 block/barrel spread, is something that's
23 discussed from time to time or mentioned.

24 A Sure. Well, particularly under the current
25 formulas where you add three cents to the barrel

1 price, and if that spread is less than three
2 cents, it ends up enhancing the overall price
3 level.

4 Q And has there historically been a difference in
5 those prices that's referred to as the
6 block/barrel spread?

7 A Yes. In fact, I had a proposal that I withdrew
8 that asked the Department to change that from
9 the three cents add-on to the one and a half
10 because I believe it averaged one and a half
11 over the most recent time period.

12 Q What time period was that?

13 A Oh, gosh, I -- I think it was back to 2003 --
14 no, I think I went back to -- I think I went
15 back through the whole time period, like a
16 six-year time period, and it went down to about
17 a penny and a half. It's been shrinking over
18 time and it's reversed itself, actually, where
19 for many weeks in the last several months the
20 barrel prices have actually been above the
21 block, but I believe over that lengthy time
22 period, it was a one and a half cent difference
23 where the block prices were above the barrel by
24 a penny and a half.

25 Q Okay. Over a six-year period?

1 A I believe -- whatever I had in my testimony, I
2 believe it was during that time period.

3 MR. BESHORE: Thank you.

4 JUDGE PALMER: Yes, any hands? Ready for
5 Redirect from Mr. Vetne?

6 MR. ROWER: We have a question over here.

7 JUDGE PALMER: Oh, question over there, I'm
8 sorry.

9 CROSS-EXAMINATION,

10 QUESTIONS BY MR. HENRY H. SCHAEFER:

11 Q Good morning, Bob.

12 A Good morning.

13 Q In the beginning of your discussion of your
14 proposal, you mention the change to both the
15 Class III and the Class I formulas.

16 A Correct.

17 Q And I assume in this case you were really
18 looking at when the Class III would be the mover
19 of Class I?

20 A That's correct.

21 Q Your proposal also includes incorporating the
22 NASS and CME for cheese, and you do not mention
23 doing that for butter.

24 Is there a particular reason you've not
25 also included that for butter?

1 A Well, I thought about doing it for butter too,
2 but I realized that what I was proposing here
3 was adding another level of complexity, okay,
4 and it didn't appear that people in the industry
5 for the butter side had the same concerns, I
6 talked to my own butter people about it, and
7 that two-week lag was an issue but it was not
8 nearly as much an issue as cheese, and so we
9 decided that we would just pursue that area
10 where we felt we had the most problems.

11 Q Along the lines of complexity by adding the CME
12 and using the two price series, do you view that
13 complexity as really being able to improve the
14 price, I guess I'll say price discovery for the
15 protein price calculation in that obviously you
16 mentioned with the CME that you would be more
17 timely, the price series basically in aggregate
18 reflect each other?

19 A Yes, that's what I was trying to do was to
20 really move the two price series closer
21 together. I had hoped, as I mentioned, for
22 example, to also help reduce some of the huge
23 fluctuations in the producer price differential.
24 Unfortunately it ended up not doing that that I
25 hoped to when I finally did the final analysis,

1 but that was the intent.

2 Q Again along the lines of the -- you talked about
3 how you weighted these.

4 A Yes.

5 Q You weighted the CME based on the NASS. Do you
6 view that as an appropriate weighting or would
7 you just use the CME as a straight, unweighted
8 average as currently as published by Dairy
9 Market News and other sources?

10 A Well, the weight is only a factor if there's a
11 significant change in the volumes from week to
12 week or within barrel and block. Within barrel
13 and block there's not a whole lot of shifting, I
14 mean occasionally there can be, but not a whole
15 lot. Week to week could matter, particularly
16 when you have holiday weeks and you have more
17 cheese being made because Class I bottlers or
18 others aren't using it or schools are out or
19 whatever, so I think weighting is still
20 important, and so the -- and the only way I
21 believe you could do that is to have some
22 measure of the production of both those
23 commodities. NASS will give you that, whereas
24 the CME will not give you that.

25 Q When you're looking at your calculation and you

1 have in Figure 2A and 2B there the weeks that
2 you would use and you've got the example here of
3 April, did you do any calculations when you were
4 doing your computations then of your prices the
5 months in which there's a five-week month and
6 then you would have a four-week on each side of
7 it or something like that, whether you'll have
8 overlapping weeks in some cases and, if so, will
9 you go ahead and use those overlaps?

10 A Okay. That's a really good question, because
11 that added a lot of complexity when I was going
12 through this thing week by week, as you can
13 imagine.

14 I used every week that was in that time
15 period involved, and the way I did it was that
16 if -- you would first approach the current
17 month, and if it had five weeks, you use the
18 five weeks, but if the previous month only had
19 four weeks, then you use four weeks for that
20 comparison, but then when you went to the next
21 subsequent month, the previous month would have
22 those five weeks, you see what I'm saying, so
23 whatever month had five weeks, you used the five
24 weeks either in the current or the previous, and
25 the same thing with the NASS, so it can add some

1 little bit of difference.

2 It's why at the end of the day when I
3 looked at the numbers they all didn't come back,
4 but they came back very, very closely, and I
5 think part of it was the weight, part of it was
6 five versus four and some of the comparisons
7 when you try to get the average, you couldn't
8 quite come back to the zero impact.

9 Q On your regressions, you used a simple linear
10 regression --

11 A Yes.

12 Q -- for your comparisons. Did you do any looking
13 to see whether autocorrelation was a factor in
14 the time series data?

15 A No, I didn't.

16 Q If, generally speaking, time series data does
17 have some autocorrelation in it, would that have
18 had an impact on your results, do you believe?

19 A It could have, but I haven't -- it's been such a
20 long time since I've dealt with regression, I
21 hadn't even considered autocorrelation on it,
22 but I've got to remember exactly what the impact
23 of autocorrelation is, but I know that one
24 number -- it's a current number -- a previous
25 number affecting the current number, and I guess

1 it could have had an impact, but I didn't
2 consider that.

3 Q And also when you made your comparisons, you
4 went back in this case back to 2000. Did you
5 make an adjustment to the barrel price for
6 moisture at that time, because during -- of
7 course, during the time period of which we've
8 used these price series, we did make a moisture
9 adjustment from 39 to 38, I believe in 2001.

10 A I used the reported NASS prices, so I did not.

11 Q Do you believe that that would have any impact
12 on your results?

13 A It certainly could, although keep -- well, it
14 could between the difference between the NASS
15 and the CME, yes. I was about to say the CMEs
16 will cancel each other -- if they cancel each
17 other out, you're basically using the NASS's
18 that USDA used during those periods, so keep in
19 mind that I'm comparing the actual prices
20 generated using the NASS reported by USDA used
21 in the Federal formulas, I'm using those in both
22 cases, so actually I think it might have
23 distorted it if I would have gone and changed
24 the NASS numbers and tried to say that it should
25 be now at 38 percent moisture where in the

1 beginning of -- in 2000 it was 39 percent
2 moisture, you see what I'm saying. I just -- I
3 didn't want to bring anything more into this
4 than just the time lag difference, so I tried to
5 use the current week bottle prices as reported.

6 Q I think I'll go back a little bit to the
7 complexity of adding these two series together,
8 and rephrase the question just a little bit in
9 that by doing so, what do you see the main
10 accomplishment that you're going to get from
11 this since the price differences are really
12 negligible?

13 A Well, over time they are, but they're not from
14 month to month, and what I was really trying to
15 do was -- going to Figure 1, was address those
16 huge differences that you see in the red bars
17 that occur primarily in 2004, really in like the
18 first half of the chart, that's the issue I was
19 trying to get at. And keep in mind that this
20 proposal was first discussed with the Department
21 in March of 2005, and that's about halfway into
22 that chart, and so the industry was looking at
23 that first half of the chart and saying there's
24 a serious problem we have to address.

25 Now, if you look at the second half of the

1 chart, it doesn't look as serious, because you
2 didn't have that huge volatility. That doesn't
3 mean that this year or next year we can't have
4 that huge volatility. We may be setting up a
5 situation of a repeat of that volatility, but
6 that was the intent of trying to address it, and
7 that was really the -- almost the sole intent,
8 although initially I did feel if we could do
9 something with those negative producer price
10 differentials, they just created a very serious
11 issue on the farm because, as you recall, in
12 2004, in one of the months, March or April, I
13 mean we had a producer price differential of
14 negative over two dollars a hundredweight. It
15 was probably three dollars a hundredweight in a
16 lot of orders, so if we could find a way to
17 reduce that, that would be a positive thing.
18 Unfortunately, when I ended up looking at what
19 happened, it didn't reduce it.

20 **MR. SCHAEFER:** Thank you, Bob.

21 **JUDGE PALMER:** Other questions over at that
22 table at all? Anyone over there? Any other
23 questions here?

24 Mr. Vetne.
25

1 DIRECT EXAMINATION,

2 QUESTIONS BY MR. JOHN H. VETNE:

3 Q Mr. Wellington, just a couple of questions on
4 some formula-related issues.

5 Yesterday Mr. Yale presented some testimony
6 and it addressed, among other things, product
7 yields and noted that there has been no survey
8 of cheese yields similar to a survey on cheese
9 plant costs.

10 Do you have any comments on making a
11 regulation, regulated prices, based on
12 hypothetical or idealized yields without such a
13 survey?

14 A Well, I think using those formulas, the
15 Van Slyke formula, to try to get at the yields
16 at a minimum price is probably the best way to
17 approach it. I mean the alternative is to go
18 sample plants for yields, and the problem is
19 there's just so much that go into the yields at
20 the plant, and, you know, it's not just a
21 question of saying how much cheese came out of a
22 vat. You have to look at how much -- how much
23 additional cream you may be adding and
24 additional milk solids, you have to look at a
25 number of those things, and then if you say

1 well, the benefits of adding those should all be
2 accrued, for example, to the Class III price to
3 benefit farmers, then what is the advantage to
4 the plant operator necessarily doing that, if it
5 all goes back to the farmers in general.

6 It's not that I'm against having farmers
7 get additional money, but our farmers own our
8 plants, and so if there's some benefits that we
9 can accrue because they take the risk and put up
10 the money, the capital for these plants, that
11 should go back to the owner of the plants, the
12 farmers, and not necessarily to all the farmers
13 in general, so we have some concerns about --
14 about doing a yield survey or something like
15 that.

16 We think that a lot of it should be a
17 negotiation process, that these are the basic
18 yields that pretty much most plants can get, and
19 if you can do better than that and you're
20 competing for milk, as we compete in our area,
21 well, then you have some additional money to
22 attract that milk to your plant.

23 Q I believe Mr. Yale's testimony suggested that
24 if -- if a particular cheese maker has a yield
25 that is lower than the hypotheticals he

1 advocated, that's something that should be
2 addressed in the marketplace.

3 Can you comment on the ability of a
4 manufacturer to respond to lower yields in the
5 marketplace when there's a minimum regulated
6 price?

7 A Well, that's it. In our area at least, in the
8 Northeast, we really try to have some level of
9 integrity on the minimum pricing. They truly
10 are the minimums. And I know that's often hard
11 to do, and we've had to get around that at
12 times, too, when there's a big surplus of milk
13 and we got to do something with it, but our
14 members, for example, are very cognizant of what
15 the blend prices are at and what they're
16 announced at, and if we pay something below that
17 blend price, they're going to know right away.
18 And we had to do that this past year because we
19 had that reblend because we had losses and
20 couldn't cover our manufacturing costs, so in
21 our neck of the woods, a minimum means minimum.
22 It means you don't pay less unless everybody
23 knows you're paying less, and then it's extreme
24 circumstances when that happens.

25 Q You indicate that in the past year or so you

1 haven't been able to recover your manufacturing
2 costs. Does that mean that you're also not able
3 to pay for the additional investments that you
4 have made recently or might make in the future?

5 A Yes, I mean we're not -- we have not spent our
6 depreciation, I don't think we spent 50 percent
7 of our depreciation in the last couple years
8 because we couldn't afford to do that, and the
9 banks basically said we couldn't afford to do
10 that, so we're not putting any new investments
11 at this point.

12 We did put new investments back in the --
13 in -- well, basically 1999 to about 2003, and we
14 put quite a bit of investment, \$7 million in our
15 cheese plants, we put \$20 million into a whey
16 processing facility, but today we could not do
17 any of those things.

18 Q Okay. If -- if the Department simply looked at
19 yields or revenue shrinkage available from the
20 most current technology available today or
21 available tomorrow or yesterday, I mean
22 literally yesterday, and created a formula that
23 assumed everybody constructed that, is there a
24 way in that formula that the people that made
25 those investments could pay for them?

1 A Well, there would have to be something in the
2 make allowance that would give them an
3 additional make allowance to cover those, as
4 well as give something to those plants that
5 don't have that new technology and allow them to
6 purchase that new technology.

7 It's just not a question of saying we're
8 going to go out and buy that technology because,
9 boy, we can be much more efficient. You've got
10 to have the money to go do that, you have to
11 have a bank willing in most cases to loan you
12 that money, and at the profitability rates of
13 cheese makers these days, those are very
14 difficult things to come by, particularly the
15 banks.

16 Q Now, in your testimony at the last session with
17 respect to the basic manufacturing costs and
18 make allowance, you relied on manufacturing cost
19 surveys and studies by CDFA, Dr. Ling at USDA
20 and Mark Stephenson; correct?

21 A Correct.

22 Q And you were here yesterday for the testimony of
23 Ben Yale.

24 A Yes.

25 Q And Ben Yale included reference to -- and

1 reproduced Dr. Ling's surveys and indicated in
2 support of Proposal 3 that the allowances that
3 Dr. Stephenson came up with for butter, powder
4 and cheese should be the ones that are
5 eventually adopted. Do you recall that?

6 A Yes.

7 **MR. VETNE:** Your Honor, I'd like to have
8 marked for this record the -- the Stephenson
9 survey material as the next consecutive exhibit.

10 **JUDGE PALMER:** Any problem with this?
11 Offhand I don't remember it. No problem? Oh,
12 you've already put a number on it, have you not?

13 **MR. VETNE:** No, that's the number from --
14 this was copied. It needs a new number.

15 **JUDGE PALMER:** Needs a new number, so make
16 it 36. I'm going to scratch out the number
17 that's on here.

18 **MR. VETNE:** 36 and 37?

19 **JUDGE PALMER:** 36 for the top one, and the
20 next one will be 37. 36 will be "Testimony on
21 Cost of Processing," and the other one is -- I'm
22 sorry, they both say "Cost of Processing."

23 **MR. VETNE:** One starts with the word
24 "Testimony." The other starts with the word
25 "Cost."

1 **JUDGE PALMER:** All right. "Testimony" is
2 36, "Cost" is 37.

3 **MR. VETNE:** Of course, this has been
4 available on the Web for about six months now.

5 *(Thereupon, Exhibit Nos. 36 and 37 were*
6 *marked for purposes of identification.)*

7 **MR. VETNE:** I made a few limited copies.
8 If you can share with your groups, that'd be
9 fine.

10 Q Mr. Wellington, with respect to Dr. Stephenson's
11 survey, Dr. Stephenson has indicated in his
12 testimony he set out to get a representative
13 sample of participating plants producing butter
14 and nonfat dry milk and cheese and whey.

15 A That was his intent.

16 Q But with respect to butter, he had lower than
17 expected participation, so he expressed lack of
18 confidence in his butter numbers.

19 A Yes.

20 Q And, similarly, with nonfat dry milk, there was
21 a lower participation than the -- than the study
22 designed.

23 A Well, actually, I think nonfat dry milk plants,
24 I think there were a similar number.

25 Our concern was the fact that butter is

1 usually, the companion product, but I actually do
2 believe on nonfat dry milk, he did obtain the
3 number. On cheese plants, he did not.

4 Q On cheese plants -- now, cheese plants, rather
5 than -- rather than a survey, random survey of
6 plants producing cheese on that one -- one
7 product, he actually split the survey into two
8 components, so he had a sample of plants from
9 the population of large cheese plants and then a
10 sample of plants from nonlarge cheese plants.

11 A That's correct, he stratified his sample, and
12 he -- the sample size, if I recall properly, I
13 believe it's 20 plants he sought, and he had
14 five large plants and -- that he geared out of
15 the stratified sample of the 10 percent of the
16 largest plants, I'd have to refer back to his
17 study, but of those plants, and then 15 plants
18 that were in the remainder of the plants. At
19 the end of his survey he had results -- indeed,
20 he had results from those five large plants, but
21 I believe he only had results from 11 of the 15
22 smaller plants.

23 Q Okay. So the less -- the lower participation
24 than desired and intended from the small plants
25 with respect to the total --

1 A Yes.

2 Q -- produced a somewhat skewed to large plant
3 result?

4 A We believe that was the case, yes.

5 Q And, similarly, by design, unlike the other
6 three commodities, by design by isolating large
7 plants in a stratified sample, the design of the
8 survey combined was intended to --

9 MR. YALE: Your Honor --

10 JUDGE PALMER: For leading is that the
11 objection, Mr. Yale?

12 MR. YALE: Well, yeah, he's testifying, but
13 I guess I can't say much about that, but my
14 concern here is that we're now starting to have,
15 without Dr. Stephenson, starting this
16 characterization of this testimony rather than
17 letting it be what it is.

18 JUDGE PALMER: I agree with you.

19 MR. VETNE: Okay, we'll let it be what it
20 is. It's been received; correct?

21 JUDGE PALMER: Well, it's been identified.

22 MR. VETNE: Okay. I ask it be received.

23 JUDGE PALMER: Is there any objection to it
24 being received? Mr. Beshore.

25 MR. BESHORE: If this is being proffered as

1 testimony without the witness, apparently it is,
2 it's in essence testimony --

3 **JUDGE PALMER:** I think that's a good
4 objection. I would receive it to the extent
5 that this witness refers to it in his testimony
6 as a source, but not as the doctor's testimony.

7 Q Mr. Wellington --

8 **MR. VETNE:** And I'd like to get back to
9 that, but let me lay some more foundation.

10 Q Mr. Wellington, did you talk to Mark Stephenson
11 about his availability to be here for this
12 segment of the hearing?

13 A Yes, I did. In fact, I originally wanted --
14 because of my -- because of my proposals,
15 particularly the second one, which was going to
16 use his methodology to update on a regular
17 basis, I felt that it was very important that
18 Dr. Stephenson be at the hearing, and so I
19 originally asked him to come to the first
20 hearing.

21 Unfortunately the first hearing, the date
22 of the first hearing wasn't known till a few
23 weeks before that hearing, and Dr. Stephenson
24 had a hip replaced during that week, so he
25 obviously could not make it.

1 And, in fact, I spoke to him to see if he
2 could make this one, and this was his first week
3 back to school, he's a professor, and so he felt
4 that he really couldn't miss doing that this
5 week. And so I did try to get him here.

6 And, in fact, in our discussion of that,
7 Dr. Stephenson offered that if the hearing were
8 to go on for a third week, and if that third
9 week was going to be held sometime after the end
10 of May, that he would be willing to update his
11 costs with another year if he could get the
12 industry to agree, and so he said the end of
13 May, I would probably say more like June. No
14 offense to Dr. Stephenson, but it always takes
15 longer to do these things.

16 And so one of the things I was going to
17 ask, and I want to do it on the stand, was ask
18 for consideration from the Department that if
19 you should go to a third week, that it be held
20 at a time -- if it could be held in June or
21 sometime no earlier than June, there might be an
22 opportunity to get that additional information,
23 more current information from Dr. Stephenson.
24 And I know that's important to the Department on
25 the make allowance hearing; in fact, the

1 Department reopened the hearing to have
2 Dr. Stephenson's information, so I would ask for
3 consideration of the Department if they -- if
4 they could go to a third week and if such a week
5 could be held in a time period that would allow
6 Dr. Stephenson to both be here to talk about
7 these testimonies and to provide updated
8 information.

9 Q And that would address, in addition to Proposal
10 No. 2, the methodology that you suggest be
11 applied by the Department in a continuing
12 survey, it would also address the Proposal No.
13 1, which proposes to use the most current data
14 available, that would provide, hopefully, 2006
15 information or a report similar to the
16 comparable most recent information available
17 from CDFA.

18 A I think what it was was his original data that
19 he put together a little over a year ago had
20 2004 and 2005 mixed data, so I would envision
21 that this data would be 2005, 2006 mixed data,
22 but hopefully it would be clearly a year more
23 current.

24 Q Right. And it would provide testimony
25 responsive also to Proposal No. 3, which -- by

1 New Mexico producers which proposes to adopt
2 some of Stephenson's results?

3 A Yes.

4 **JUDGE PALMER:** Well, just for clarity's
5 sake, all of that I give over to the Government
6 table and they can let me know what, if
7 anything, they want to do when it comes to
8 Friday of this week.

9 Meanwhile, though, the exhibit is being
10 received, but only as a source of material to be
11 used by the witness, not as a substitute for
12 Dr. Stephenson's testimony, regardless of what
13 his problems are.

14 **MR. VETNE:** Your Honor, there were two
15 exhibits. One was entitled "Testimony" and one
16 was entitled "Cost of Processing," which was --

17 **JUDGE PALMER:** Well, we'll let them both
18 in. This witness is competent to work with
19 them.

20 **MR. VETNE:** Okay. My question is whether
21 Your Honor's limitation applied equally to both?

22 **JUDGE PALMER:** Yes.

23 **MR. VETNE:** The limitation, as I understood
24 it, applied to testimony, but you're saying it
25 applies to both?

1 **JUDGE PALMER:** It applies to both. You
2 really need him to explain the exhibit that he
3 prepared. We'll do it that way, something that
4 you can use, but it's not his testimony.

5 **MR. VETNE:** Okay. Your Honor, of course,
6 to the extent necessary, I take exception to
7 that limitation, and --

8 **JUDGE PALMER:** You can argue it on brief.

9 **MR. VETNE:** And I will address it on brief
10 and perhaps later in the hearing. Thank you.

11 **JUDGE PALMER:** Great.

12 *(Thereupon, Exhibit Nos. 36 and 37 were*
13 *received into evidence.)*

14 **JUDGE PALMER:** Any other questions? Yes,
15 Mr. Yale.

16 **CROSS-EXAMINATION,**

17 **QUESTIONS BY MR. BENJAMIN F. YALE:**

18 Q In the "Cost of Processing in Cheese, Whey,
19 Butter and Nonfat," I'm not sure, is this 3- --

20 A 7.

21 Q 7. In the back of that is an Appendix A. It
22 starts at page 12.

23 A I have a copy, but I'm missing page 12.

24 Q Well, do you have page --

25 A I have 13.

1 Q Well, I'm looking at the wrong exhibit. I'm
2 looking at the one that has the study. I'm
3 looking at his -- I think it's the one that has
4 been posted on the Web site, but he had the --
5 how the program worked. I may have given you
6 the wrong exhibit number.

7 A No, I think you gave me the right one, Ben, I
8 just don't have -- I'm missing that page 12.

9 MR. ROWER: There is no page 12.

10 Q Okay. Do you have the Cornell Cost of
11 Processing Program?

12 A Cost of Processing in Cheese, Whey and Butter,
13 September 1, 2006.

14 Q Yeah, but then he has an appendix attached.

15 A Okay, let me -- the page that has 12 says --
16 that says "Appendix A -- Directions." Is that
17 what we're referring to?

18 Q Yes.

19 A Okay. I'm sorry. I have that page.

20 Q That uses a different label on the thing. Okay.
21 Have you read that Cornell Cost of Processing
22 Program?

23 A Back quite a while ago when he first -- when the
24 report came out last September, I -- to the
25 extent I remember what I remember.

1 Q And you were here when he testified?

2 A Yes.

3 Q And I'm not sure whether you asked any
4 questions, but you were aware of the line of
5 questions and his testimony.

6 Did he at any time indicate that as part of
7 the collection of the data, he requested the
8 plants to exclude the costs associated with
9 improving plant yields or efficiency?

10 A I don't recall that, Ben. He may have; I just
11 don't recall it.

12 **JUDGE PALMER:** You see, that's the whole
13 problem with taking an exhibit in, you don't
14 have the person who prepared it.

15 **MR. YALE:** Well, I'm not trying to get -- I
16 want his recollection because it's a setup for a
17 follow-up question of Dr. -- or Mr. Wellington.

18 **JUDGE PALMER:** I'm sure you have a good
19 reason and you'll -- go ahead, Mr. Yale.

20 Q The question really comes down to this, is that
21 when they collected this cost of these plants,
22 there was no adjustment made for what kind of
23 yields or types of operations or anything else
24 that were made.

25 A I don't believe there was.

1 Q Okay. Now, in the NASS survey, I know you
2 testified you don't participate in it, but
3 you're aware of --

4 A Well, Ben, if I can just correct that. To the
5 extent that yields would affect the number of
6 pounds of product produced, okay, yields were
7 incorporated for the total cost by the pounds
8 produced, but there was no intent to look at
9 yields specifically as a separate category.

10 Q So to -- right, there's nothing as a separate
11 category, right. Now -- but there is a function
12 between the yield and the average cost to make
13 per pound, though; right?

14 A Certainly, because it affects the number of
15 pounds made.

16 Q Now, the -- you indicated that you don't
17 participate in the NASS survey, but you've seen
18 the NASS cheese product prices form that you
19 fill out to report that; right? Are you aware
20 of the standards for that?

21 A On cheese?

22 Q Yes, or nonfat dry milk.

23 A Nonfat dry milk, we do participate on nonfat dry
24 milk, and back at the very beginning I met with
25 our plant staff on that, but, boy, we've been

1 reporting that for many years, so that'd be a
2 stretch for me to try to remember the details.

3 Q So would you be able to tell me whether or not
4 there's any statement on there in terms of
5 choosing what products and what prices based
6 upon the yields that they received on the -- in
7 making those products?

8 A Not that I recall. I think it's a very
9 straightforward -- I can tell that I would have
10 faced a lot more resistance from our plant staff
11 about reporting it if it was any more complex
12 than it was, which was basically the pounds and
13 the price.

14 Q Now, but in the reporting -- you participated in
15 the RCBS study; right?

16 A Yes.

17 Q And you also participated, I believe, in the
18 Cornell study, or not? Were you one of the
19 lucky drawees?

20 A Yeah, we were. Actually we were the first plant
21 on the cheese side that Dr. Stephenson visited.
22 He spent a lot of time in our operations trying
23 to perfect the form and whatever, working with
24 our accounting people and what have you, because
25 we obviously had an interest in getting it done

1 as quickly as possible, so our Middlebury plant
2 was included, and our West Springfield plant was
3 included on butter and powder.

4 Q Okay. And in those discussions with
5 Dr. Stephenson, you took him through the plant,
6 did you suggest to him to ignore any processes
7 or equipment that might improve the yields of
8 the operation, or was that all included in what
9 you showed him?

10 A Oh, we didn't suggest he ignore anything. We
11 just gave him a complete tour of the plant,
12 answered all his questions that he had relative
13 to the operations of the plant. To the extent
14 that our plant was atypical, which it's not
15 really atypical, but if there was anything, we
16 made sure we pointed that out to him.

17 Q So you reported all of the costs associated with
18 that plant and showed him all the equipment and
19 so that he had a sense of what the capital
20 investment is for that total plant; right?

21 A That's true.

22 Q And you have no reason to believe he did
23 anything else with the other plants that were
24 part of the survey?

25 A No, I don't, and, in fact, I believe he probably

1 did likewise because I know he -- well, at least
2 he testified that he visited all the plants.

3 Q Right. Right.

4 JUDGE PALMER: We're really getting into
5 what Dr. Stephenson did and now we're sort of
6 trying to get into his mind and --

7 MR. YALE: I'm not getting into
8 Dr. Stephenson's mind.

9 JUDGE PALMER: Yes, you are. Yes, you are.
10 You said did he do the same for the other
11 plants, and he wasn't at the other plants.

12 MR. YALE: Well, let me just ask the
13 question.

14 Q There is nothing in his -- in that cost -- that
15 cost study includes all of the costs associated
16 with that plant, including whatever it took them
17 in terms of personnel and equipment and
18 investment to produce product at -- at the yield
19 that that plant generated; right?

20 A As far as I know, yes.

21 JUDGE PALMER: That's what you're assuming?

22 MR. WELLINGTON: Yes.

23 JUDGE PALMER: All right. We'll allow it
24 that way. He's assuming that those were the
25 conditions of the study and what Dr. Stephenson

1 did, and when he then used this exhibit for
2 whatever purposes he's using it for, that was
3 his assumption.

4 **MR. WELLINGTON:** Yes, thank you.

5 Q And then one final thing. By the way, we would
6 support having Dr. Stephenson's information. I
7 mean we're not looking at the numbers, we're
8 looking at the process, and we think that's a
9 valuable process.

10 One of the things, though, that -- do you
11 have an opinion as to whether this study should
12 undergo some independent review or audit just to
13 ensure that the -- you know, there's no
14 mathematical errors made or, you know, something
15 else? I mean we're all -- Dr. Stephenson is
16 very smart but, you know, sometimes we make a
17 mistake.

18 A Ben, I think that would be an excellent idea.
19 In fact, it's one of the reasons why we're
20 proposing that the market administrator auditor
21 staff review this on a regular basis because we
22 think that can be the case. I mean we have no
23 problem with that because we know the numbers of
24 what were reported at our facilities, and so
25 that'd be great, we'd be happy to open our books

1 to an auditor on that, and we'd like to know
2 that other plants also have complete costs, so
3 we would have no problem.

4 **MR. YALE:** I have nothing further.

5 **JUDGE PALMER:** Any other questions?

6 All right. We're going to complete with
7 you on that, and I guess you're going to go on
8 to your testimony after lunch on the next
9 section. What's your situation?

10 **MR. WELLINGTON:** I think we're done.

11 **JUDGE PALMER:** You said you had other
12 things for him.

13 **MR. VETNE:** That's what I just did,
14 Your Honor.

15 **JUDGE PALMER:** You just did it?

16 **MR. VETNE:** Yes.

17 **JUDGE PALMER:** When I wasn't looking.

18 **MR. VETNE:** I just did that. We just
19 completed him.

20 **JUDGE PALMER:** You're complete. Have a
21 good trip.

22 We'll see you at a little after one.

23 **MS. PICHELMAN:** Your Honor, I just wanted
24 to make sure that Mr. Wellington's testimony was
25 received into the record. Was it received?

1 **MR. VETNE:** Oh, yeah, 35.

2 **MS. PICHELMAN:** Exhibit 35, his actual
3 testimony.

4 **JUDGE PALMER:** Oh, yes, yes. We're
5 receiving 35.

6 **MS. PICHELMAN:** Thank you.

7 **JUDGE PALMER:** Very good. Thank you.

8 *(Thereupon, Exhibit No. 35 was received*
9 *into evidence.)*

10 *(A luncheon recess was taken.)*

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

2 TIMOTHY P. GREENWAY,

3 having been first duly sworn in by the Judge,
4 was examined and testified under oath as
5 follows:6 **JUDGE PALMER:** We're on the record. Okay,
7 Mr. Greenway has been called as a witness and
8 has been sworn.9 **MR. VETNE:** Your Honor, Mr. Greenway has a
10 statement called a Declaration which he prepared
11 in the course of the session starting in
12 February, which I distributed in February, again
13 posted on the Internet about a week ago, and I'd
14 like that marked as the next consecutive
15 exhibit.16 **JUDGE PALMER:** That would be 38.17 *(Thereupon, Exhibit No. 38 was marked for*
18 *purposes of identification.)*19 **MR. VETNE:** That's been around a long time.
20 Mr. Greenway would like to waive the reading of
21 that, but I have some additional Direct or exam
22 questions of it.23 **JUDGE PALMER:** Well, that's your statement,
24 Mr. Greenway?25 **MR. GREENWAY:** Yes, it is.

1 **JUDGE PALMER:** That's been marked as
2 Exhibit 38. Why don't you go on to your
3 questions, additional questions.

4 **DIRECT EXAMINATION,**

5 **QUESTIONS BY MR. JOHN H. VETNE:**

6 Q Mr. Greenway, your statement is focused
7 primarily on fat recovery in the Foremost
8 facilities; correct?

9 A That is correct, sir.

10 Q And just to summarize, what is -- what is the
11 fat recovery you obtain?

12 A In our Marshfield location, which is a cheddar
13 producing 40-pound blocks, we've historically
14 and currently get about 90.25 percent butterfat
15 retention.

16 Q Okay. That's produced in 40-pound blocks?

17 A That's 40-pound blocks.

18 Q What type of vat do you use?

19 A We're using a Damrow Double OO vat.

20 Q What kind of vat is that, vertical, horizontal,
21 lateral? I don't know what they are.

22 A Well, how do I phrase it in relationship to
23 that. Let's just say instead of being a
24 vertical vat, it's a horizontal vat, and it's
25 kind of like when you look through binoculars

1 and merge them together, that's kind of what you
2 would have there.

3 Q Okay. There are vats available to cheddar
4 cheese makers and to other cheese makers that
5 are newer and have some improved technology.
6 Are you aware of that?

7 A Yes. Yes, sir.

8 Q Horizontal cheese vats, the Scherping kind that
9 Mr. Yale referred to earlier.

10 A Uh-huh.

11 Q Are you familiar with those kinds of vats?

12 A Yes, I am.

13 Q And have you looked into procurement of that
14 kind of vat?

15 A Yes, we've looked at the technology several
16 times at Foremost, and, you know, do believe
17 they are a very capable vat indeed.

18 Q Okay. Do you believe that that kind of vat
19 would somewhat improve your fat retention in
20 cheese?

21 A Yes. Yes, there's no doubt. The vats we're
22 dealing with, the Double OOs that we have from
23 Damrow, which has been a very reliable and good
24 vat, you know, with 90.25 percent, I'm sure that
25 our retention values can get up much higher.

1 They have improved technology in the Scherpings
2 that you mentioned. They have less depth, okay,
3 which gives you a consistency in relationship to
4 the -- when you do the cut, the tension of the
5 curve from top to bottom, you have less
6 stratification. You also -- you know, the
7 radius that they have on those vats is
8 consistent, it's a little bit more narrow, so
9 when you're doing a cut or a stir with them, you
10 basically have about the same speed or have
11 closer speed from the tip of the radius to the
12 center, and so that allows you to be a little
13 bit more gentle.

14 Q So there are vats out there that will produce
15 somewhat better butterfat retention?

16 A Yes, sir.

17 Q Why haven't you put them in your plants if
18 they're out there?

19 A We've analyzed it several times, and usually the
20 constraining factor tends to be the investment
21 dollars relative to the payback.

22 Q What do you mean by that?

23 A Well, for an example, in the Marshfield facility
24 we have eight vats in there, and in looking at
25 replacing those with the type of vats you're

1 talking about, that's probably going to cost us
2 about \$5 million to make that investment just to
3 replace the vats alone.

4 Q Five million dollars in one plant?

5 A Yes.

6 Q To replace eight vats?

7 A Yes. That would be installing -- taking out the
8 old vats, installing the new ones, process
9 piping, controls, etc., yes. That's probably a
10 minimum number that it would take to do that.

11 Q That's equipment and labor costs?

12 A Yes.

13 Q And whatever salvage you get from the --

14 A The old vats, yeah.

15 Q The old vats. In addition to the cost for new
16 equipment and new labor and new fitting and so
17 forth, would you have costs because of reduced
18 capacity or closing of the plant?

19 A Oh, sure. Anytime you take down a facility
20 within our multi network of ten plants that we
21 have, you're going to have to end up moving that
22 milk into some other product, so, first of all,
23 physically you're going to have to move it from
24 the location, so you're going to have
25 transportation costs associated with that. And

1 then obviously whatever the other product is it
2 goes into on a temporary basis, we would have to
3 see what the markets were, but that also may be
4 a loss -- or a cost, I should say, in
5 relationship to that installation.

6 Q So for ten days -- of course, that depends on
7 the season too?

8 A Yes, absolutely.

9 Q You have more milk in the spring, less milk in
10 the fall, some days you would have weather
11 problems that might interrupt installation, that
12 kind of thing.

13 A Uh-huh. Uh-huh.

14 Q You have to say yes.

15 A Yes.

16 Q Okay. Have you looked into how long it would
17 take to recover your investment with that
18 somewhat added fat retention?

19 A Yes, we've done that actually several times.
20 And this last -- in preparation in relationship
21 to testimony here, we looked at it again in
22 regards to the economic value that was put forth
23 by the USDA in their February 2007 economic
24 forecast that said that the retention would be
25 something like -- increased retention would be

1 \$13 per hundredweight, was the value that was
2 offered in that, at least for Scenario C, which
3 was a multitude of butterfat, protein and other
4 recoveries, and using that with 2006 numbers,
5 basically on a straight payback, that would
6 be -- which it's not including the time value of
7 money, etc., that'd be something like 7.2 years
8 for that particular facility.

9 If you include such things as the
10 depreciation and tax impacts, the way that a
11 true accountant would look at it or a lender
12 would look at it, that's going to actually
13 lengthen out. If you're using like 6 1/2
14 percent interest rate, which is a conservative
15 number, would be something like about a 13 year
16 payback.

17 Q All right. And how much would it cost, did you
18 say, for the downtime or alternate --

19 A The downtime, you know, we use -- from the
20 pounds that hit that facility that would have to
21 be moved, you know, it's going to be something
22 like 8.1 -- it's going to be 1.8 million pounds
23 at, you know, 50 cents per hundredweight
24 transportation cost is going to get you
25 someplace around 90,000 for that ten days.

1 Q How many plants does Foremost operate?

2 A We currently operate ten cheese facilities.

3 Q And have you estimated your total cost to put
4 that kind of equipment in all of your plants?

5 A Well, on a very rough basis, if we were putting
6 that in all ten plants, you have more or less
7 complexity in relationship to egress and
8 entrance to the -- getting in the plants, you
9 know, actually physically getting the vats in,
10 but if you just do a quick, simple extension on
11 that five million per plant, we're talking about
12 \$15 million, which in 2006 we had about
13 \$138 million worth of plant, property and
14 equipment, and so that's about, you know,
15 36 percent of our value to replace into that
16 type technology.

17 Q And if you were going to consider that, how
18 would you finance it?

19 A We'd have to take it to our bank. We do our
20 financing currently through CoBank, which is the
21 bank that does cooperatives, and so in doing
22 that, we'd have to take this to them, our
23 proposal, we'd have to show our payback similar
24 to what I've just stated here today.
25 Unfortunately, in relationship to that

1 particular statement is is that if we end up
2 paying that out in the minimum Order price and
3 paying that amount, we would not have that
4 return of 13 or 7.2 years because we'd end up
5 paying it in milk price.

6 Q Okay. So if the -- if the hypothetical
7 additional revenue or the additional revenue
8 from this type of new equipment from greater fat
9 retention were included in a minimum Order price
10 payable to producers, you would not have a
11 return on that investment to show your bankers,
12 you would not be able to recover it even in 13
13 years?

14 A That would be correct.

15 **MR. VETNE:** Your Honor, I ask that
16 Mr. Greenway's declaration be received, and
17 offer him for Cross-Examination.

18 **JUDGE PALMER:** All right. We'll do that,
19 it'll be received.

20 *(Thereupon, Exhibit No. 38 was received*
21 *into evidence.)*

22 **JUDGE PALMER:** Do we have questions?
23 Mr. Yale.

24
25

1 **CROSS-EXAMINATION,**

2 **QUESTIONS BY MR. BENJAMIN F. YALE:**

3 Q Good afternoon. I'm Ben Yale with Select Milk
4 Producers, Dairy Producers of New Mexico,
5 Continental Dairy Products from Michigan, Ohio
6 and Indiana, and then Zia Milk Producers from
7 New Mexico and Lone Star of Texas and other
8 states.

9 A Good afternoon.

10 Q Mr. Greenway, I want to follow up on that last
11 comment. I kind of got around that there will
12 be a cost, and I think that's always assumed,
13 there's a cost to invest into the more modern
14 vats; right?

15 A Yes, sir.

16 Q Okay. You've testified to that. And then
17 you've said that by just looking at straight --
18 I assume by straight cash flow, it'd take seven
19 and a half years, and if you include
20 depreciation and tax and everything else, it's a
21 13 1/2 year payback; right?

22 A Yes, sir.

23 Q How long have you had the vats that you
24 currently have?

25 A They have been in place, I would say -- of

1 course, we have numerous plants and stuff, but
2 that's basically '70s and early '80 technology.

3 Q Okay. These are fairly permanent fixtures that
4 are purchased; right?

5 A Yes. That's how come the ten days to, you know,
6 replace them. In fact, in a place like
7 Marshfield, we don't have easy access to it
8 because it's been built around that, and so it
9 takes considerable time to get into that. It's
10 the main part, it's the hub of the cheese plant,
11 so it takes quite a lot to replace these.

12 Q Now, would you go over again with me what you
13 just told Mr. Vetne, that you would invest --
14 that you're not going to be able to get the
15 money back because you end up reporting that to
16 NASS and then -- am I missing this, and then
17 NASS raises the price and therefore you can't
18 pay -- you aren't going to have any cash flow.

19 How is it that you don't get any recovery
20 back?

21 A Well, the argument put forth there is
22 essentially that if we change the minimum Order
23 portion and take it to 94 percent recovery,
24 which has been proposed, we essentially -- that
25 benefit which I stated from the USDA number,

1 that 13 cents, would essentially be paid out, so
2 if that's the economic value of basically going
3 from where we are right now, which is 90, we're
4 at 90.25, they talked about going to 94, being
5 the 13 cents per hundredweight, if we change
6 that, we then will pay that out in relationship
7 to producers, so -- if the Order is changed and
8 that factor goes to a 94 percent retention, and
9 so at that point I don't -- as a manufacturer, I
10 don't have the recoup of that basically 13 cents
11 to apply against my investment because I'm
12 paying out to producers, which we're happy to
13 do, but we're always looking to try to optimize
14 that as a cooperative.

15 Q So you've made a business decision that you can,
16 without increasing your -- or changing your
17 plant, that you can deliver to your producers
18 the most money that you can at this point in
19 time; is that right?

20 A We're always looking to optimize that, of
21 course, and so we're looking for investments
22 that have shorter paybacks. If we retrofit a
23 plant and change it, we're going to assess
24 technology replacement of those parts, of
25 course, that's the time that it makes sense to

1 do that, and there's no doubt in my mind that we
2 probably would replace those vats to take
3 advantage of the new technology that's out
4 there, but it's kind of difficult to do that
5 once you have that investment in the ten plants,
6 it's the heart of your facility. Unless you're
7 retrofitting to do, you know, a new type of line
8 or new type of product, working with our
9 customer base, we're generally -- just have not
10 been able to show that we can get the return by
11 simply replacing the vats.

12 Q You've mentioned your product line. Of all of
13 your plants, what percentage of the cheese is
14 reported to NASS?

15 A It's going to be -- it's going to be a smaller
16 percentage there. I'd have to say I don't know
17 that number exactly.

18 I know that in regards to Marshfield, which
19 does produce the 40-pound block, that about
20 85 -- like I have in the statement, about
21 85 percent of it is cheddar. About 21 percent
22 of that volume in that same time, which is 2006,
23 was reported on NASS, okay. The difference
24 there being within the NASS numbers you only
25 pick up white -- you pick up colored and not

1 white, and we produce a lot of white cheddar at
2 that location, so that excluded a number of it.

3 It is our only -- out of the ten plants,
4 it's a good scale plant, but we only --
5 currently right now we're only producing cheddar
6 in one other location, so it's going -- I don't
7 know what the number is, but it'll be -- you
8 know, if it goes up to 85 percent and go down to
9 21, it's going to be a fairly small number.

10 Q Are all the others American style, cheddar type
11 cheeses, though?

12 A A lot of the other plants are going to be
13 Italian, mozzarella, provolone, etc.

14 Q And those would use a different style vat?

15 A No, actually we use almost exclusively the
16 Double OO vats in our locations, except for one
17 location in Wilson which uses a horizontal vat,
18 but it's not that different horizontal.

19 Q But there's -- it's still true the cost to
20 produce is still the same?

21 A Yes, yep, we're cooking and stretching, yeah,
22 going through a water bath.

23 Q In your market, do you pay producers amounts in
24 excess of the 3 and 4 or the minimum -- I'm
25 sorry, not 3 and 4, but the minimum prices under

1 the Federal Orders?

2 A Yes, we do. In relationship to meeting
3 competition in our area, we're pretty much
4 forced to do that. Of course -- and forced may
5 be the wrong terminology there because we want
6 to try to do that also to meet the marketplace,
7 I mean, and for the benefit of our producers.

8 Q Now, by the way, I do appreciate the effort made
9 to try to bring to the Department what you
10 thought your -- what you represent to be the
11 value of your butterfat recovery. A lot of
12 plants were unwilling to do that, and I
13 appreciate that. I think it's helpful to all of
14 us.

15 But one of the questions I have, and I
16 wasn't sure whether you were saying this or not,
17 so the question, I'm going to -- I want to talk
18 about your butterfat recovery.

19 First of all, do you buy any cream to add
20 to your plant -- your vats?

21 A No. In the Marshfield plant, we are strictly
22 taking in milk and basically producing the full
23 fat cheddar from the domestic supply.

24 Q So you're doing a full fat cheddar?

25 A We're doing a full fat cheddar. We also do

1 some -- as you can see from these things, we do
2 some reduced fats. That's done in relationship
3 to standardization or adding nonfat dry milk.

4 Q Okay. So you do some fortification?

5 A Yes.

6 Q Do you take any of your whey cream and put it
7 back into the vat?

8 A That's not done in relationship to our American
9 plants. And that's done in relationship to a
10 couple things. You have some issues in
11 relationship to our flavor profile that can
12 happen with a cheddar cheese, and so whey cream
13 is not reutilized at that Marshfield facility.

14 Q The -- so for the amount of butterfat that comes
15 into the door in the plant from the producers
16 and the amount that goes out in the form of your
17 cheeses at Marshfield, you're saying that 90 --
18 approximately 90 percent of that shows up in the
19 cheese; is that correct?

20 A From the attachment there, you can see it
21 actually is 90.25, and it's been fairly
22 consistent with that. I mean if you go back
23 through the years, that's pretty much what we're
24 able to perform at at that location.

25 Q And the other 9.75 percent is either -- shows up

1 primarily in whey cream that you sell?

2 A Yes.

3 Q Now, you talk about a factor over here on the
4 whey cream of 14 percent less for sweet cream of
5 the same fat content.

6 Now, there was -- I don't know whether you
7 were here this morning when the gentleman from
8 Twin County testified. Were you here?

9 A No, I was not, sir.

10 Q He testified that there was a multiple that he
11 was paid for his whey cream times the CME butter
12 price; is that --

13 A That's what actually is being reflected here is
14 is that difference in the multiple.

15 Q Okay. So the multiple might be like 1.28 or 1.3
16 for the butterfat, the full -- the good cream --
17 I shouldn't say good, but the fresh cream, and
18 then maybe like 1.10 or 1.12 or 1.15 for the
19 whey cream?

20 A That is correct, sir.

21 **MR. YALE:** I don't have any other
22 questions. Thank you.

23 **JUDGE PALMER:** Questions? Mr. Beshore.

24

25

1 **CROSS-EXAMINATION,**

2 **QUESTIONS BY MR. MARVIN BESHORE:**

3 Q Good afternoon, Mr. Greenway.

4 A Good afternoon.

5 Q Marvin Beshore. I represent Dairylea
6 Cooperative and DFA in this hearing.

7 Just a few more questions about your
8 operations at Marshfield. Can you tell us
9 approximately what the volume per day of milk
10 receipts are at Marshfield?

11 A It tends to be about 1.8 million pounds when
12 we're producing. You know, sometimes you have
13 some down days, but when it's in operation, 1.8
14 million pounds.

15 Q That's sort of what, an average year around?

16 A Yeah, I get that number actually from 2006
17 figures.

18 Q Okay. Now, of the production at Marshfield, you
19 say 85 percent is cheddar. Was it 21 percent of
20 the 85 percent was reported to NASS or 21 --

21 A No, you have that correct. Of the 85 percent
22 that is in the cheddar category, 21 percent of
23 the total production, okay, in total is what
24 was -- it's 21 percent of that -- no, excuse me,
25 21 percent of the total volume was reported to

1 NASS.

2 Q Of the total volume at Marshfield?

3 A Total volume, yeah.

4 Q So roughly a quarter of your cheddar production?

5 A Yes. Yes, sir.

6 Q Now, the non-NASS cheddar, are there any
7 differences in production cost of that product
8 versus your NASS cheddar?

9 A Outside of the -- the stuff that meets the same
10 standard of identity as cheddar, meaning the
11 full fat cheddar that we produce and its color,
12 other than the color, that's basically the same
13 product, and so then what you go down to is
14 basically that they have different packaging,
15 which that's also a consideration if it's picked
16 up in NASS, and -- but other than that, you're
17 running through the same process.

18 Q So help me. Does color add to the cost or
19 lessen the cost?

20 A We haven't been able to get our suppliers to
21 give us the color free at this point, so, yes,
22 that adds to the cost.

23 Q So the NASS is more expensive to produce then?

24 A Yeah, the NASS is slightly more expensive. It's
25 a very minimum number. The color is not that

1 expensive in the total picture of things.

2 Q So your non-NASS cheddar, is it then sold off
3 the block market?

4 A Yes, it's -- the vast majority of everything
5 that we sell there is based on the CME, the
6 average weekly CME, usually a week delay, and
7 that depends a little bit on the customer then
8 what the actual week is.

9 Q What, if you know, approximately is the -- is
10 your -- your selling price for your production
11 at Marshfield comparable to the reported NASS
12 selling prices for the Minnesota-Wisconsin
13 region?

14 A It's going to vary, you know, depending on what
15 area it may be going into and depends on the
16 labeling. Like I mentioned before, we do have a
17 label that goes out East, it's been there for
18 many years, 195127.

19 Q I'm familiar with that.

20 A Good. Hopefully you have some. And that gets
21 probably a little bit more premium than your
22 standard nonaged cheddars, so there's -- like
23 most manufacturers, there's a range that you get
24 and that's different from the CME value.

25 Q Okay. So if I just extend that out, if we

1 looked at the published NASS weighted average
2 prices for 40-pound blocks for the Minnesota and
3 Wisconsin area, okay, and compared that to the
4 CME price for the same time -- you know, for
5 roughly the same time period, setting aside for
6 the moment the lag there, are those -- are those
7 values representative of the values that you're
8 able to obtain for your production?

9 A You know, so you're saying the actual price per
10 pound of cheese, is that what you're coming up
11 to?

12 Q Yes, the published NASS weighted average price
13 for 40-pound blocks in Minnesota-Wisconsin.

14 A I would say that they generally are higher than
15 that, they're higher than that value.
16 Specifically, of course, from a proprietary
17 standpoint I don't want to say how much higher,
18 but they would run a little bit higher than that
19 from a value stand.

20 Q With respect to the fat, butterfat retention
21 figure, I want to -- in paragraph 15 of your
22 declaration, you sort of break down I think the
23 method of that calculation, and I want to be
24 sure that I understand it.

25 Do you start with farm weights and tests of

1 your member milk?

2 A Of course we have those in hand. What we're
3 actually starting with here as far as this key
4 measure and measurement goal is actually in the
5 door, so we're scaling -- we're scaling those
6 routes in, and that's what's actually being
7 entered into our system that produces these
8 numbers, so we're looking at a scaled, measured
9 reading at the plant.

10 Q You scale the truck, scale the weight in, scale
11 it before and after?

12 A Yes.

13 Q And that's the -- the butterfat is based on the
14 sample before the truck's unloaded, I take it?

15 A Right. It's -- what we utilize there would be
16 the sample that is taken. At that particular
17 time the -- there's a little bit of mix here in
18 relationship to what goes on there. We will use
19 that number if we're bringing in vendor milk,
20 non-patron milk. We're going to utilize the
21 value we're sampling right at that point in
22 time.

23 If we're utilizing our own Foremost Farms
24 milk, it's going to go back to the samples taken
25 at the farm.

1 Q Okay. That's what I -- that's what I thought I
2 got from your description here in 15. So the
3 butterfat for your ratio, the butterfat starts
4 with, you know, in essence the gross butterfat
5 measured at the farm?

6 A Yes.

7 Q With respect to whey cream, you say it's sold
8 from the location to third-party buyers. Do I
9 understand that to be that the -- it's sold FOB
10 Marshfield?

11 A Yes, that's correct.

12 Q Mr. Yale asked you this, but I want to make
13 sure -- or asked you about this generally.
14 Is -- we had testimony this morning that an FOB
15 plant multiple would be -- and this was from
16 Iowa, was -- for whey cream was about 1.14. Is
17 that -- is that an accurate number?

18 A Without saying the specific, because I did not
19 reflect that here, I would say it's actually a
20 touch lower than that in our case.

21 Q And the -- and that's times the double -- CME AA
22 market price?

23 A That's correct.

24 Q Okay. Now, what is a typical -- do you sell --
25 you sell some sweet cream from Marshfield?

1 A No, we do not -- we don't have a separator
2 there, so we don't sell any sweet cream from
3 that location.

4 Q But do you sell sweet cream from other
5 locations?

6 A We do separate in what would be our balancing
7 plants, our butter puff plants, and so in those
8 cases sometimes we will sell cream from those
9 locations, sometimes those will go to our
10 consumer products division, go into different
11 products there, salt cream being one of them, so
12 we both use it internally, of course, to make
13 butter from it and we do also sell the cream.

14 Q Now, you made a comparison in paragraph 13 of
15 your declaration which is Exhibit 38 of the
16 price of whey cream versus sweet cream. What
17 did you use for the price of sweet cream for
18 that comparison?

19 A Well, since I wasn't going to specifically
20 reflect what the whey cream was, I'm not going
21 to say specifically what the sweet cream one was
22 as well. But, essentially, again, that value
23 that we're using is a typical number
24 representative of what we're able to get in the
25 marketplace.

1 Q Okay. Well, I'm interested -- you used a
2 14 percent differential, and I'm just
3 specifically interested in what was the
4 numerator, what was the denominator of the
5 14 percent.

6 A Uh-huh.

7 Q Can you help me?

8 A Well, I could, but if I do, in that case I'm
9 basically saying specifically what I'm -- what
10 I'm getting for those, those values, and I would
11 prefer not to do that.

12 Q Well, I'm interested in how -- you've got the
13 14 percent in there. I think in order to be
14 able to use that or for that to be meaningful,
15 we have to have some idea of what the -- you
16 know, is that -- if you took a sweet cream
17 number, say we use the 1.14, I know that's not
18 your number, okay, say we used a -- you know, a
19 1.28 for sweet cream, is that difference of .14,
20 is that your 14 percent?

21 A That is the type of calculation that would be
22 done to come up to that 14 percent. I'm looking
23 at the divisor of the number which is the whey
24 cream relative to the sweet cream and inversing
25 that minus one to basically come to the

1 14 percent.

2 Q So which was the numerator and which was the
3 denominator, sweet cream or whey cream? I mean
4 which was the numerator?

5 A I don't recall right now. I mean I'd have to
6 physically do the calculation again.

7 Q It would make a difference, would it not?

8 A Oh, yes. Yes.

9 Q But you're not sure which was which?

10 A No. No. It's been since I did this testimony
11 for the last time, or when I did that and wrote
12 this up that I did that calculation, so I don't
13 recall it at this point.

14 Q Okay. Do you purchase any of the -- of the whey
15 cream and use it internally within Foremost?

16 A No, we -- as a matter of fact, we sell -- any
17 whey cream we have we sell external, and we do
18 not process any whey cream internally on our
19 own.

20 Q You do make butter, do you not? Foremost does
21 produce butter, does it not?

22 A Yes. Yes. We just don't produce any B butter.

23 Q There's been some testimony I think in the
24 earlier -- in the earlier hearing, some
25 indication that the state of Wisconsin does not

1 require for A butter, for its A butter -- it has
2 its own state A butter designation, AA butter,
3 does it not?

4 A That could be. I'm -- I have to plead ignorance
5 here, I'm not a butter expert.

6 MR. BESHORE: Okay. I don't think I have
7 any other questions at the moment. Thank you.

8 JUDGE PALMER: Thank you very much, sir.

9 MR. GREENWAY: Thank you.

10 JUDGE PALMER: And we've received your
11 statement.

12 Who do we next have as a witness?

13 MR. ROSENBAUM: Jon Davis is next.

14 MR. YALE: By the way, Your Honor, for
15 information, Mr. Wolfe has been here today and
16 has a three- or four-page statement in the back
17 of the room.

18 JUDGE PALMER: All right. We'll take him
19 right after Mr. Davis.

20 JON DAVIS,
21 having been first duly sworn in by the Judge,
22 was examined and testified under oath as
23 follows:

24 JUDGE PALMER: We'll mark this statement as
25 39, Exhibit 39.

1 (Thereupon, Exhibit No. 39 was marked for
2 purposes of identification.)

3 **MR. ROSENBAUM:** Ready, Your Honor?

4 **JUDGE PALMER:** Yes.

5 **DIRECT EXAMINATION,**

6 **QUESTIONS BY MR. STEVEN J. ROSENBAUM:**

7 Q Good afternoon. Why don't you start by telling
8 us your name for the record.

9 A Jon Davis.

10 Q And, Mr. Davis, where are you employed?

11 A Davisco Foods.

12 Q What is your position there?

13 A General manager.

14 Q And how long have you been with Davisco?

15 A Twenty-three years if you count my first day I
16 walked in the door.

17 Q What does Davisco do?

18 A We make -- we buy milk and we make cheese and
19 whey products.

20 Q Where do you have facilities?

21 A LeSueur, Minnesota, Lake Norden, South Dakota,
22 and Jerome, Idaho.

23 Q And what kind of cheeses do you make?

24 A We make all forms of cheddar from no fat to full
25 fat. We make mozzarella, we make Parmesan, we

1 make Asiago, we make Romano, and that's about
2 it.

3 Q Now, Mr. Davis, you are familiar with the fact
4 that the International Dairy Foods Association
5 has Proposal No. 12 which would amend the Class
6 III and Class IV product prices' formulas by
7 limiting the three cent cost adjustment for
8 cheese manufactured into 500-pound barrels;
9 correct?

10 A Yes.

11 Q And you are here, in part, to testify in favor
12 of that proposal; is that correct?

13 A Absolutely.

14 Q And we have had marked as Exhibit --

15 **MR. ROSENBAUM:** And, I'm sorry, Your Honor,
16 that number again, please?

17 **JUDGE PALMER:** 39.

18 Q -- Exhibit 39 a document that has been posted on
19 the USDA's Web site for more than a week now.
20 These are some spreadsheets that you put
21 together that address this three cent issue in
22 Proposal No. 12; is that correct?

23 A Yes.

24 **MR. ROSENBAUM:** All right. Your Honor, we
25 have distributed copies of Exhibit 39. We also

1 thought it might be helpful to have it -- it's
2 only a couple pages, to have it projected and
3 Mr. Davis can help us, lead us through it.

4 **JUDGE PALMER:** Fine. Does he need to step
5 down to see the screen?

6 **MR. DAVIS:** I have a copy right here.

7 **JUDGE PALMER:** You can do it that way. I
8 see it. Okay.

9 **MR. DAVIS:** Maybe I can just talk through
10 it, Steve.

11 **JUDGE PALMER:** You're going to have to
12 stand over there and do it.

13 **MR. ROSENBAUM:** Okay. I think I may --

14 **JUDGE PALMER:** You're the technical wizard.

15 **MR. ROSENBAUM:** I'm not sure I am.

16 **MR. DAVIS:** And as we do this, I can give
17 you a little background as to where these costs
18 came from.

19 Q All right.

20 A In our LeSueur plant, which is in southern
21 Minnesota, it's regulated, I think it's under
22 Federal Order 30, I should know that, but I'm
23 pretty sure it's Federal Order 30, we make
24 40-pound blocks and 500-pound barrels, and the
25 nice part about this comparison using it at

1 LeSueur is we put this system in from an
2 antiquated system in 1999, and we put in the
3 block plant and then we put in the barrel plant,
4 so it's very easy to assess both capital costs,
5 which are very significant in both of those
6 processes, but also obviously operating and
7 variable costs which are shown here, so that's
8 the example in LeSueur.

9 And there was -- some of the USDA folks
10 were there a couple years ago and we gave a tour
11 and we had it all roped off which was the
12 block -- which was dedicated to block
13 production, which was dedicated to barrel
14 production, and we do both in the same plant, so
15 everything ahead of the packaging room is the
16 same, essentially; the cheese vats, the cheese
17 draining tables, the milk pasteurizer, whatever
18 else you have ahead of the packaging room and
19 everything downstream in terms of whey
20 processing, so it's a nice comparison between
21 the two. And we'll get to the capital on the
22 second page. We'll go through the operating
23 first.

24 But what you see, the line items, the
25 individual line items you see here on the left

1 are making the 40-pound block, and those are our
2 actual costs for everything you have to do to
3 put a piece of 40-pound cheese in acceptable
4 packaging and sell it on the -- either
5 commercially in the industry, in the trade, or
6 sell it on CME.

7 Q All right. So under the heading 40-pound box
8 with liner, you have a series of items. And I
9 take it these are the various items you need to
10 buy and utilize in order to pack a 40-pound box;
11 is that right?

12 A Yeah. I can walk through them. The first one's
13 a pouch. Out of a cheese tower where you form
14 this 40-pound block, you push the cheese block
15 into a pouch, plastic pouch, and it's 17 cents
16 apiece, so every block that comes through there
17 has to have a pouch on it.

18 And then you put a cardboard box around it,
19 and that includes a liner and a box that goes
20 around the liner, and you can see the various
21 costs there.

22 You have to put a label on it, tell, you
23 know, when it was made, where it was made, what
24 vat it's at for product recall and traceability,
25 things like that.

1 The hot melt is the glue you use to make
2 the box adhere to itself so it stays closed.

3 The stretch wrap goes on after you have a
4 group of 54 blocks on a pallet. The stretch
5 wrap is what keeps them together so when they go
6 in the truck they don't fall all over.

7 On that pallet you have a cardboard pallet
8 pad, and then you have a pallet itself.

9 In addition, when you're talking about
10 40-pound blocks, when you sell on the Merc., and
11 for the most part when you sell commercially,
12 you have to put color, annatto, in the milk to
13 make colored cheddar, so. Cheese is normally
14 white, so you have to add the color. And I
15 add -- as you can see here, we have a line item
16 for color costs.

17 In addition to that, in order to make it
18 apples and apples with making a barrel of
19 cheese, you have to get that whey stream back
20 decolorized, you have to bleach the annatto out
21 of what's left in the whey stream, so as you can
22 see, there's a line item there for decolorizing
23 that whey back to white so you can process it
24 into whey products and essentially be on par
25 with barrel production.

1 Q All right. So you have a one column called
2 Block, and that's the -- as I understand from
3 your testimony, the absolute cost, for example,
4 a pouch costs 17.5 cents, etc.; correct?

5 A Yep.

6 Q And then you have next to that a column for
7 Pound, which is simply derived by what, dividing
8 the block column by 40 pounds; is that right?

9 A It better be, but, yeah, that's how it is.

10 Q All right. And the bottom line is --

11 A Elvin makes a good -- thanks, Elvin. I think we
12 used 42, you're right, because that's what most
13 of our blocks are. Thank you, Elvin. I knew
14 you'd help me today.

15 Q And the bottom line is what is your per pound
16 cost of packaging for the 40-pound blocks?

17 A For variable costs, and this is just what it
18 takes to put packaging around a 40-pound block
19 or 42-pound block, it's .02574 per pound.

20 Q And has that -- have you now told us what we
21 need to know about the 40-pound block side of
22 the document?

23 A Yes, in terms of variable costs.

24 Q All right. Take us now to the right-hand side
25 of this page, which is called Fiber Barrels.

1 A Yes. We also can make barrels in the same
2 production facility in LeSueur, we do it also in
3 Idaho as well.

4 And what is necessary to make a saleable
5 barrel, both to the Merc. and also to the trade,
6 is on that -- on the right side of the ledger.

7 You need a barrel liner, which is similar
8 to a pouch except that it's a lot bigger because
9 you're putting it in a three and a half, four
10 foot barrel. You have the fiber barrel itself
11 which is spec'ed and accepted by the Merc. as
12 saleable on the Merc.

13 We have labels on there. You have to have
14 two different labels on there, and that's
15 required. We have stretch wrap because you put
16 four barrels on a pallet when you ship it, so we
17 have to stretch wrap those so the barrels don't
18 fall over. And then we have the pallet itself.

19 Q And those are all per unit costs in the barrel
20 column; right?

21 A Yes. And there's 510 pounds in a barrel.

22 Q So, for example, barrel liners cost 99 cents
23 each, if I understand this correctly?

24 A Yep.

25 Q And then in the pound column, you're dividing

1 the numbers in the barrel column by 520 pounds;
2 is that right?

3 A 510.

4 Q 510, all right. And the bottom line per pound
5 cost, therefore, for packaging 500-pound barrels
6 is what?

7 A .022926.

8 Q Now, this is information with respect to your
9 LeSueur facility; correct?

10 A Yes.

11 Q You've got a little note at the bottom about the
12 Jerome Cheese Company's barrel cost. Tell us
13 what that represents.

14 A Well, Jerome is kind of out in the middle of
15 nowhere, if anybody knows where Idaho is. In
16 order to get the barrel to the facility, we have
17 to add a little bit for freight, and that's 1.57
18 a barrel more.

19 Q Other than that, though, as your note indicates,
20 the costs at Jerome are similar; correct?

21 A Exactly the same.

22 Q All right. Have you taken us through the first
23 page?

24 A Yes.

25 Q All right. We're now on the next page of

1 Exhibit 39. Tell us -- take us through that, if
2 you would, please.

3 A And, again, we did this in '99, so these were
4 capital costs in terms of construction costs in
5 late '98 and through '99. And we -- obviously
6 we added a building and then the equipment to be
7 able to handle both types of production.

8 And as you can see in the square footage
9 column, it takes a significant amount more
10 square footage to be able to make barrels than
11 it does to be able to make 40-pound blocks, and
12 the reason for that is 40-pound blocks come nice
13 and flat on a big pallet and you fold them up
14 and your machine takes care of it and wraps a
15 block around your 40-pound block.

16 You actually have to have the physical
17 500-pound barrels stored, and it takes a
18 significant amount of area to store them before
19 you use them, and an even more significant
20 amount of area to store them after they're full.
21 So that's why you can see the difference between
22 square footage. Those are actual costs, what we
23 spent when we built both packaging rooms.

24 Q All right. The first three entries under the
25 heading Building have a (k) in parentheses to

1 the right of them, and then your footnote
2 explains those are the expenses that pertain to
3 40-pound blocks; correct?

4 A Yes.

5 Q And then your next two entries under Building
6 have an (r) next to them, and that indicates
7 that that relates to the barrels; correct?

8 A Yes.

9 Q So basically this is how much it cost you to
10 construct the building with respect to the
11 size -- the area that needed to be set aside for
12 pounds on one hand and 500-pound barrels on the
13 other; correct?

14 A Yep.

15 Q All right. The next heading then is Equipment.
16 Take us through that, if you would, please.

17 A We have 40-pound block cheese equipment, and
18 those are cheese towers, we have a rapid cool,
19 rapid cooler which is necessary when you make
20 40-pound blocks to be able to sell on the
21 Exchange, and that is like a chill tunnel for
22 40-pound blocks, and then we have the
23 decolorizing equipment that is necessary when
24 you're going to make 40-pound blocks that have
25 color in them to decolorize.

1 Barrel room equipment is just filling the
2 barrel and then physically handling it to get it
3 to a capping stage, account for it from a weight
4 standpoint and putting it into the cooler.

5 **JUDGE PALMER:** Off the record for a second.

6 *(A discussion was held off the record.)*

7 Q And, once again, these are all actual costs,
8 these aren't estimates?

9 A These are costs that were taken from invoices.

10 Q Okay. Now, the -- the next entry says Total,
11 40-Pound Block Production of \$3,931,900.21.

12 Just tell us how that's -- the math behind that.

13 A That should be, and I'm sure it is, the three
14 line items, the 40-pound block cheese equipment,
15 the 40-pound block rapid cooler, and the
16 40-pound decolorizing equipment, and -- excuse
17 me, and the building necessary to house all
18 that.

19 Q So it's a summation of the entries above that
20 relate to the 40-pound block side of the
21 business?

22 A The ones with (k) by them.

23 Q And similarly the total barrel production figure
24 of \$5.1 million, roughly, is the same with
25 respect to the barrel side; correct?

1 A Yes.

2 Q Tell us what you did then on this -- with
3 respect to the next couple line items.

4 A Well, if you look down at the bottom under the
5 assumptions, you have an interest rate, which
6 obviously at the time was a lot better than it
7 is today. We have equipment life of fifteen
8 years. And then we have a plant capacity, which
9 in this case is the same for both blocks and
10 barrels, we sized it for that, and we can do 78
11 million pounds, give or take, of cheese through
12 that plant and ultimately through the packaging
13 equipment both sides. And I used those figures
14 to get the capital costs, and then backed that
15 into a per pound capital cost.

16 Q And that -- the per pound capital cost then for
17 the 40-pound blocks is?

18 A .0051 per pound, and for barrels it's .0067.
19 And then at the bottom I added up the operating
20 variable costs for both with the capital costs
21 for both.

22 Q The operating variable costs were the ones that
23 had appeared on page 1; correct?

24 A Yes.

25 Q So that the total packaging and capital costs

1 for 40-pound block production is a summation of
2 the .025740 on the first page plus the .0051 on
3 the second page?

4 A Yes.

5 Q And the total packaging and capital cost for
6 500-pound barrel production of .0296 is a
7 summation of the 0.022926 on the first page plus
8 the .0067 on the second page; correct?

9 A Yes. It was when I sent the worksheet to you.

10 Q Well, believe me, the last thing I would have
11 done is touched those numbers.

12 So bottom line, and which of course is
13 where all this leads us, how do the total
14 packaging and capital costs compare between the
15 production of 40-pound blocks and 500-pound
16 barrels?

17 A In my world, they're essentially the same, but
18 they're, you know, .0012 per pound different, so
19 a third decimal.

20 Q So you have to go to the third decimal before
21 you find any difference at all; correct?

22 A Absolutely.

23 Q And this -- your analysis certainly does not
24 support the current three cent adjustment that's
25 in the formulas; correct?

1 A No. Contradicts it, obviously.

2 Q And for that reason, you believe the three cent
3 cost adjustment that's currently in the formula
4 should be eliminated; correct?

5 A Absolutely eliminated.

6 Q Mr. Davis, anything else you think you would
7 like to tell us with respect to this specific
8 issue, the Proposal 12 and the comparison of
9 producing blocks versus barrels?

10 A There's a lot more, but you told me I could only
11 talk on this.

12 Q Well, no, we'll start with this subject, but
13 anything else on this particular subject?

14 A No. No.

15 **MR. ROSENBAUM:** Your Honor, at this point I
16 would like to ask that this exhibit be --
17 Exhibit 39 be accepted into evidence.

18 **JUDGE PALMER:** Any objection? Received.

19 *(Thereupon, Exhibit No. 39 was received*
20 *into evidence.)*

21 Q Mr. Davis, you obviously know a lot about the
22 cheddar cheese manufacturing.

23 A Some days my father would say no, but, yeah, I
24 think so.

25 Q Tell us a little bit about losses that are

1 suffered during -- losses of fat that are
2 suffered during the cheese production process.

3 A Well, every time you touch a fat globule, you
4 affect its ability to be retained, so the
5 more -- the least amount of times you can touch
6 a pound of milk or a fat globule, the better
7 chance you have of retaining it in cheese. And
8 I think -- I've heard a lot of the testimony,
9 I've read a lot of the testimony, I've read a
10 lot and heard the dialogue in the past, but at
11 the end of the day as we're trying to ascertain
12 values of fat and recoveries of fat, I think you
13 got to keep your eye on the ball in terms of the
14 economics of those, and what I mean by that is
15 when you fill a cheese vat up with milk, there's
16 a certain -- there's certain pounds of fat in
17 that, and we measure it every vat we make. We
18 make 120 vats a day. We measure every pound of
19 fat that goes in there, and certainly there's
20 some inconsistencies in the measurements, but
21 those are just inherent, but what we do is value
22 that fat that gets in there, and we put a volume
23 number to it, how many pounds.

24 And when you're all done, you sell a block
25 of cheese or a barrel of cheese and you have a

1 volume number of fat in there that you get paid
2 for as cheese.

3 There's a lot of stuff that happens in
4 between, but when you think about the economics
5 and what you're trying to do in a formula for
6 raw material pricing, those two things have to
7 stand a little taller than some of this minutia,
8 which is important, but can get in the way of
9 really analyzing the economic effects and the
10 economic abilities of a cheese maker to grab a
11 pound of fat and put it into a saleable product.

12 Q And do you reprocess your whey cream?

13 A No, we don't. Our -- we have yet to find
14 customers that accept that. In addition to
15 that, we've done -- there's an economic issue to
16 it in addition to a quality issue in terms of
17 flavor. The flavor of the cheese is not as good
18 because the fat's been through a lot more
19 damage, a lot more activity, it's been through a
20 cheese vat, been through a cheese table, been
21 through a clarifier, probably, or a fine saver,
22 been through a separator, been through a
23 pasteurizer for the second time at a higher
24 temperature to try to kill all the starter
25 organisms, gone back into storage and now you're

1 going to pump it back into the cheese vat.

2 And when we did trials to see if our
3 customers, from an economic standpoint, not to
4 mention quality and flavor, when we did trials
5 for that, we found that the fat recovery of that
6 whey cream fat was significantly less than the
7 original fat -- ability to recover fat from, you
8 know, a pound of milk. As much as -- if you can
9 get 80 percent of your whey cream fat in your
10 cheese, from the trials we've done, and we did
11 extensive trials because we tried to make it
12 work, you're doing a heck of a job.

13 So that whey cream that's getting
14 regurgitated and recycled, you don't have the
15 ability not only to separate it in a separator,
16 but you also don't have the ability to catch it
17 in a casein micelle.

18 Q Some of the fat obviously ends up in the cheese,
19 some in the whey cream. Where else does fat end
20 up?

21 A You have -- subject to -- when we take the whey
22 off the cheese vats and the cheese tables, there
23 are pieces of fines in there, and in order to
24 properly whey process, you have to get those
25 fines out of there, so you either take it

1 through a fine saver, which is a mesh filter, or
2 you take it through a centrifuge, and there's
3 fat lost in the decanting or de-sludging of
4 those pieces of equipment, and then you run it
5 into a separator to try to get all the fat out,
6 because when you process whey, you don't want
7 fat in your whey if you can help it; you can't
8 get it all out, but you try. And in that
9 separator you have de-sludgings and other yield
10 loss. That fat that started, you know, coming
11 out of the cheese vat in the cheese table gets
12 lost, whether it's down the drain, whether it's
13 on the side of the pipes, wherever.

14 In addition, you have salt whey that you
15 don't recover, for the most part, and there's a
16 heavy amount of fat that ends up in the salt
17 whey.

18 **MR. ROSENBAUM:** That's all I have at this
19 point.

20 **JUDGE PALMER:** All right. Questions?
21 Mr. Beshore.

22 **MR. DAVIS:** Marvin's got his calculator
23 out, that means something's wrong, Steve.
24
25

1 **CROSS-EXAMINATION,**

2 **QUESTIONS BY MR. MARVIN BESHORE:**

3 Q I just want to check my mental vat. Jon, do you
4 report your blocks and barrels to NASS?

5 A Yes. Excuse me, we report what is -- the NASS
6 survey has certain requirements over what types
7 of cheeses you can report, and all of our
8 cheeses that meet those requirements we report.

9 Q Can you tell us roughly what proportion of
10 your -- what percentage of your production is --
11 meets the NASS specs and is reported?

12 A Off the top of my head, Marv, I'd say
13 45 percent, maybe 40.

14 Q Is that both at Minnesota --

15 A That's company-wide.

16 Q Company-wide. Fine.

17 A We make a million pounds a day, so 450,000
18 pounds a day.

19 Q What is the average moisture content of the
20 barrels you produce?

21 A It varies to style, but somewhere between 32 and
22 35 generally. We make a couple products that
23 are in the 36 range. You can't sell anything
24 over 37 in the trade or to the Merc., so
25 anything over 37 is not -- doesn't meet the CFR.

1 Q But yours tend to range from 32 to 35?

2 A And that's all customer driven. If they like
3 the piece of cheese in that area and they like
4 the machinability of it, they like the fitness
5 for use, so we adhere to that. If they want 36,
6 we can run a 36.

7 Q How about on the block side?

8 A Well, the -- the requirements at the CME are 36
9 and 39, and we try to get as high as we can
10 without going over, so, because the more
11 moisture you sell, the better off you are.

12 Q So with respect to your -- you know, your unit
13 cost information, the block that you're -- that
14 you're pricing at in terms of capital and
15 variable costs would be roughly 39 percent
16 moisture?

17 A Well, actually the controlability of your system
18 isn't that good. I'd say 38 or just south of
19 38.

20 Q Okay. So we could use 38?

21 A I'd say 37.75.

22 Q 37.75, okay. Good. And the barrel then that
23 you're -- the barrel -- the pound of barrel
24 cheese that's been priced here, what would be
25 the moisture content of that?

- 1 A Shooting from the hip on an aggregate average,
2 I'd say 34, but that's priced -- we have a
3 moisture table that prices that accordingly.
- 4 Q Okay. So for your cost per pound of production
5 for a pound of barrels -- for a pound of barrel
6 cheese that costs you .0296 cents to produce,
7 you have .64 --
- 8 A .66.
- 9 Q .66 dry matter?
- 10 A Yes, I do.
- 11 Q And for the block, you would have .6225 dry
12 matter?
- 13 A Yeah. Correct. Yeah.
- 14 Q Okay. So you get more dry matter for the buck
15 in your barrels than in your blocks; correct?
- 16 A Yes.
- 17 Q So if we were to allocate your costs of
18 production, as you have done here, over the dry
19 matter in that end product, your cost for barrel
20 production is less per unit than for block;
21 correct?
- 22 A Well, it's less per unit anyways, but you would
23 say it's even more less?
- 24 Q It's even more less.
- 25 A Your revenue reflects that, because you have a

1 moisture pricing table on barrels that you don't
2 have on blocks. The block price is a flat
3 price. If it's 139 today, that's what it is.
4 If the barrel price is 136 and you have 34 dry
5 matter -- or 34 wet moisture versus 35, your
6 price reflects that.

7 Q Right. So the price reflects -- the price
8 really reflects the amount of dry matter in that
9 pound of cheese?

10 A Yes.

11 Q On the barrels.

12 A Yeah.

13 Q Right. And it's standardized on blocks, so it's
14 not an issue, essentially?

15 A Yeah. You'd just give money away if you're at
16 36.1 versus 38.1.

17 Q Okay. So back to my question, then. I think
18 the answer is yes, that it costs you less per
19 pound of dry matter to produce barrels than it
20 does per pound of dry matter in blocks?

21 A But I don't think it's relevant because you have
22 to package both. You can't -- you're not
23 separating the water out and making powder.

24 Q Oh, I understand, but your costs include all of
25 your capital and all of your packaging; correct?

1 A Absolutely, yeah.

2 Q Okay. And just so -- if we're really comparing
3 apples to apples, shouldn't we be pricing that
4 out in terms of the cost of packaging a pound of
5 dry matter?

6 A Well, you're selling it as a whole.

7 Q I understand, but you -- but it's sold -- you
8 told us the price, and it's reflected in the
9 NASS. It's not any secret. It's reflected in
10 the NASS price.

11 A Inaccurately in the NASS because it uses 38
12 versus 39, but it is reflected.

13 Q In any event, in the barrel, the barrel
14 adjusts -- the barrel prices are higher at
15 moisture?

16 A If you've looked at it from a dry matter basis,
17 Marvin, I can't disagree with you.

18 Q Now, traditionally there's been a spread between
19 blocks and barrel prices in the cheese market;
20 right?

21 A Yes.

22 Q Okay. And how long have you been involved in
23 the cheese business? You probably testified to
24 that, but --

25 A Well, I mean where I'm privy to that type of

1 stuff, probably 16, 17 years.

2 Q And over those -- over that period of time,
3 there's pretty much always been a spread --

4 A Yeah.

5 Q -- in the prices?

6 A Yeah.

7 Q Barrels lower and blocks higher?

8 A Well, of late it's been an inverted spread
9 actually.

10 Q I understand, very recently, but if you look
11 over the 16, 17 year period, there's been a
12 spread with barrels lower, and that's been
13 reflected, according to the Secretary of
14 Agriculture, USDA, that was reflected in the
15 three cents that's built into our price
16 formulas.

17 A Yeah, and I think if you look at the record,
18 there was never any specific data like this. I
19 think it was kind of an old cheese industry
20 wives' tale that there was three cents'
21 difference. There was never any data that I
22 know of, and, in fact, when we met with these
23 folks in LeSueur, they confirmed that, so I
24 think this is the best data that's been
25 presented subject to the old wives' tale that

1 three cents is the difference between blocks and
2 barrels.

3 Q But you don't know what that difference in cost
4 now is if you convert it to per pound of dry
5 matter?

6 A No, I mean I'd have to look at it. And I don't
7 agree that that's the way to do it, but I
8 appreciate that -- for what you're trying to
9 accomplish, that's the way you want to look at
10 it.

11 Q Absolutely.

12 A Absolutely.

13 Q And the market reflects that because it
14 prices -- as you've indicated, price is varied
15 per pound of dry matter.

16 A The market reflects it accurately. The USDA
17 survey and the USDA pricing reflects it
18 inaccurately by using the 38 moisture. Nobody
19 in the industry, not one person that makes
20 barrels in the United States cheese industry,
21 uses 38 moisture as a base to reflect their
22 moisture adjustment. Everybody uses 39, but the
23 USDA has chosen to use 38. Why I don't know.

24 Q But you're not proposing to correct that 38
25 versus 39 adjustment?

- 1 A I'm not, but I think somebody will be.
- 2 Q Okay.
- 3 A They limited what I can talk about.
- 4 Q Okay. You want to --
- 5 A And I'm following right to their limitations.
- 6 Q Right. You want to eliminate the difference,
7 the three cents that was historically based on a
8 cost difference, you want to eliminate that
9 completely?
- 10 A Absolutely. The marketplace prices barrel
11 cheese and prices block cheese today. It does
12 it effectively. That's what should be reported.
- 13 Q Now, when you sell your -- would you agree, as
14 some witnesses have testified that, you know,
15 the great majority of cheese is sold off the
16 block market?
- 17 A I don't know of any barrel cheese that's sold
18 off the block market, and I think I'm the second
19 largest barrel manufacturer in the country.
- 20 Q The great majority of cheese in the -- in the
21 Class III production in the Federal Milk Order
22 system is sold off the block market?
- 23 A If you're talking Class III formula, I'd say no.
24 60-some percent is barrel.
- 25 Q No, I'm talking about cheese produced, all

1 cheeses produced in the Federal Order System.

2 A Okay, nothing to do with NASS?

3 Q Nothing to do with NASS.

4 A Okay. Yeah, I would say that -- I would venture
5 to guess that the majority, especially if you
6 talk about Parmesans, Asiagos, Romanos,
7 mozzarellas, they're certainly priced off the
8 block market.

9 MR. BESHORE: That's all I have.

10 MR. DAVIS: Thanks, Marvin. Great to see
11 you, again.

12 JUDGE PALMER: Yes, Mr. Vetne.

13 MR. DAVIS: Hi, John.

14 MR. VETNE: Good afternoon.

15 **CROSS-EXAMINATION,**

16 **QUESTIONS BY MR. JOHN H. VETNE:**

17 Q You used a term that hasn't appeared in this
18 record, and I think hasn't appeared in the prior
19 record, salt whey.

20 A Yes.

21 Q Could you describe what salt whey is and how
22 it's produced?

23 A Well, once you -- you have to salt the cheese
24 for a number of reasons, flavor development and
25 also control of bacteria. You -- that whey

1 can't be recovered as sweet whey because of the
2 salt content, so you separate and segregate
3 that.

4 Q In what process of cheese making is the salt
5 whey created?

6 A In the cheddaring process, on the drain -- in
7 most cases on the drain table or the draining
8 belt.

9 Q On the drain table after the -- after the sweet
10 whey has already been removed?

11 A Yep.

12 Q And the cheese is either draining or being
13 pressed; is that right?

14 A Yep.

15 Q And at that point is the cheese warm?

16 A It's a hundred degrees, give or take, cheddar.

17 Q Cheddar..

18 A Yep. Maybe a little less than that at that
19 time.

20 Q Something close to the melting point of butter?

21 A No, I'd say less than that, because if you had
22 that, you'd have fat leaching. I'd say closer
23 to 90 degrees. I think we fill our containers
24 at 86 to 87.

25 Q What do you do with the salt whey that comes off

1 at that point that's different from sweet whey?

2 A We have to segregate it, we have different
3 storage systems for it, and then we try to get
4 rid of it at the lowest cost possible. It's a
5 cost. We have to haul it somewhere, we have to
6 have somebody take it. You know, in a lot of
7 states you have issues with EPA, DNR, in Idaho
8 it's called DEQ, in order to be able to put salt
9 on, say, land application sites.

10 Q So you take the salt whey as it leaches or drips
11 from the cheddar, store it for a while and then
12 dump it someplace?

13 A Dump it somewhere.

14 Q You don't put it down the drain because that'd
15 be --

16 A The city or our treatment plant would have an
17 issue being able to treat that effectively, so
18 land application is the next best thing.

19 Q All right. You spoke a little bit about the
20 difference in barrel cheese between 39 percent
21 moisture and 38 percent moisture.

22 JUDGE PALMER: Is there a question?

23 MR. VETNE: Yes, there is. It's coming.

24 JUDGE PALMER: All right. I'm sorry.

25 MR. VETNE: It's what I do.

1 Q Cheese produced with 39 percent moisture versus
2 38 or 37 has moderately greater yield simply
3 because of the lower moisture content?

4 A Yes, the 39 versus 37.

5 Q Right. So when Mr. Beshore indicated that your
6 price is higher when you have 37 percent
7 moisture cheese than 38 percent moisture cheese,
8 it would be a higher price offset by the cost of
9 lower yield?

10 A Absolutely.

11 Q Okay. Do you know how those measure out, if the
12 costs to produce lower moisture cheese offsets
13 the extra income?

14 A It's -- theoretically when we -- we're talking
15 barrel cheese, I assume.

16 Q Barrel cheese.

17 A Theoretically it should be near a wash, because
18 you get a moisture adjuster the lower your
19 moisture is, the higher your solids, dry matter
20 is.

21 Q Theoretically.

22 A There's inaccuracy in the tests that are
23 inherent and we do samples after samples and
24 study after study. There's a certain inaccuracy
25 just inherent that is going to be there that

1 Kraft, for example, is going to say they got a
2 hundred million pounds of water from us one year
3 and we're going to say they got 99 million
4 pounds, that's a big difference on that volume,
5 but that formula, if everything was perfect,
6 would immediately -- or exactly match.

7 Q But people, manufacturers, nevertheless, are not
8 indifferent to moisture content; they tend to
9 strive toward 39 percent in barrel cheese?

10 A In barrel cheese we strive to what the customer
11 wants, and our customer base likes 34-ish.

12 Q Okay. So you have a considerably lower yield
13 and then a price commensurate with that?

14 A Exactly, and hopefully offsets that lower yield.

15 Q What do you do with your whey cream?

16 A We sell it to a butter maker. Year after year
17 it gets harder to sell because there's been a
18 considerable consolidation in the cream buying
19 industry and there's less and less of those
20 cream buyers that want whey cream at all,
21 because it's a product that they'd rather not
22 deal with. Our plants have access to only one
23 buyer. It's Grassland Dairy. They've
24 considerably lowered the price for whey cream
25 over the last couple of years as they've

1 acquired competitors, and I foresee that to
2 continue, so it's a battle.

3 Q When you say your plants have access to only one
4 whey buyer --

5 A Whey cream buyer.

6 Q -- whey cream buyer, does that mean that the
7 plant in Idaho, as well as South Dakota and in
8 Minnesota, are all selling to the same buyer?

9 A Yes. It's a lot better to have multiple buyers.

10 Q All right. You didn't come prepared for this,
11 but I'm going to ask you anyway. Do you have a
12 portion, albeit small, of your cheese that
13 doesn't meet specs or is off grade or for some
14 reason you can't sell for full market price?

15 A Absolutely.

16 Q Did you indicate whether you reported your
17 cheddar production to NASS?

18 A We do, yeah.

19 Q And when you report your cheddar prices to NASS,
20 do you include prices for off grade?

21 A No. They --

22 Q Don't include that volume?

23 A They don't allow that.

24 **MR. VETNE:** Okay. Thank you.

25 **JUDGE PALMER:** More questions? Mr. Yale.

1 **CROSS-EXAMINATION,**

2 **QUESTIONS BY MR. BENJAMIN F. YALE:**

3 Q Good afternoon. Ben Yale on behalf of Select
4 Milk and others.

5 You indicated you were the second largest
6 barrel manufacturer in the United States.

7 A I believe it. If we're not, we're tied, but,
8 okay.

9 Q So you could be first?

10 A We're not first, no. The partners of your
11 clients are first.

12 Q When you -- would you suggest, though, that what
13 you've indicated here in the spreadsheet both on
14 the paper exhibit and on the screen represents
15 one of the higher efficient processing of blocks
16 and barrels?

17 A I would say that it's more -- LeSueur is -- at
18 78 million isn't a very big plant, I mean in our
19 world. It's an average-sized plant I think in
20 today's world. Our Idaho factory is about two
21 and a half or three times bigger than this, so I
22 would say we're -- for our size, we're
23 efficient, but I think over the whole scope,
24 we're probably middle of the road or just above
25 middle of the road.

1 Q So there are some plants out there that don't
2 quite have these efficiencies in handling these
3 products?

4 A No, I guess -- I meant from a global efficiency
5 standpoint. Now, these efficiencies are
6 inherent in the size, the size of the plant gets
7 taken into account, because when you talk about
8 a pouch that goes on a 40-pound block, it really
9 doesn't matter if you make a million pounds a
10 day or 20 million because it's a unit cost, so I
11 don't know if the efficiency globally of the
12 plant is relevant as you try to look at the
13 block/barrel costs.

14 Q You don't reach -- the volumes to get the
15 cheaper prices are reached much lower; is that
16 what you're saying? To buy the pouches at a
17 cheaper price, the volumes necessary are much
18 lower than the size of your plants?

19 A No, I think we do well that way because we
20 have -- obviously make a million pounds of
21 cheese a day, that's a decent amount and
22 suppliers tend to answer the phone when we call
23 and give us competitive pricing. We have a
24 central buying group for everything.

25 Q You talk about the fact you don't use -- or that

1 you sell your whey powder, you indicate that you
2 lose about 20 percent of the whey cream in the
3 processing of the whey cream that you have for
4 various reasons.

5 What percent of the butterfat that comes
6 into the plant goes out into the cheese?

7 A Can you explain, I don't -- 20 percent.

8 Q You indicated that 80 percent of the whey cream
9 that you recovered was all that you were able to
10 sell.

11 A No, what I said -- at least what I tried to say,
12 maybe I didn't say it --

13 Q Well, maybe you said it, I misunderstood it.

14 A I said when we did studies to see if we could
15 use whey cream in standardizing to full fat
16 cheddar, instead of 90 percent fat recovery on
17 what raw milk would be, if you were able to get
18 80 percent fat recovery on the fat you used that
19 was whey cream fat --

20 Q Oh, okay. So this is the butterfat recovery,
21 not so much the percent of whey cream that got
22 into the vat.

23 A Right. So if somebody used whey cream in their
24 process --

25 Q They're going to have a lower butterfat

1 recovery.

2 A On that fat, absolutely lower.

3 Q Because it would impact on the proteins in the
4 processing.

5 A No, it'd impact on the fat globule membrane, it
6 can't get retained; harder to get retained, I
7 should say.

8 Q Now, on your first page of your exhibit, you had
9 color and decolor for the blocks and not for the
10 barrels, and why was that?

11 A If you sell to the Merc., you can't -- you can't
12 sell colored barrels, and you have to sell
13 colored blocks, and for the most part, the trade
14 mirrors that.

15 Q Okay. That was my next question.

16 A Yeah, I mean you -- there are some people that
17 want white cheddar blocks. It's a very small
18 part, at least in my world. And I should say I
19 think the NASS survey concurs with the Merc. I
20 think if you're on the NASS survey, your blocks
21 are colored, I think.

22 Q I think you're right.

23 **MR. YALE:** I have no other questions.

24 Thanks.

25 **JUDGE PALMER:** Very well. Mr. Beshore, you

1 have another question or so?

2 MR. BESHORE: I do.

3 CROSS-EXAMINATION,

4 QUESTIONS BY MR. MARVIN BESHORE:

5 Q Maybe I missed this, Jon, but were you asked
6 what your fat recovery is, fat retention?

7 A Well, I think he asked and I moved it away, and
8 I didn't even try to.

9 It's subject to cheese type, and I would
10 say -- and, again, the way I look at fat
11 recovery, I don't care what happens in the
12 middle, I only care what I pay for and what I
13 can sell stuff for.

14 I would say it's near 90 to 90 1/2 on an
15 aggregate over all the types of cheese that
16 would be included in the NASS survey and any CME
17 sales we have. Now, we make a lot of other
18 cheeses that have -- all of them have lower fat
19 recoveries, like mozzarella, Parmesan, Asiago,
20 Romano, those all have lower fat recoveries than
21 that.

22 Q But in NASS cheeses, is there variation between
23 your blocks and barrels?

24 A No, not a lot. I mean over -- over the
25 aggregate, not a lot. And we have days that are

1 better and we have days that are worse. And
2 things happen, you got people that are impacting
3 it and computers impact it and equipment impacts
4 it.

5 Q Do you --

6 A And, in fact, the way dairy farmers handle the
7 milk impacts it.

8 Q Do you fortify your production lines?

9 A Yes.

10 Q With what ingredients?

11 A You name it. It's economics driven. If nonfat
12 powder's economically viable at a certain time,
13 which it's not today, we'll do that. If UF
14 concentrates are available out of California or
15 New Mexico and it's economically viable, we'll
16 use that, but all of those recoveries take into
17 that that raw material.

18 Q You fortify with cream at times, fat cream?

19 A Very rarely. In all of our milk sheds we're fat
20 surplus, so we would bring other solids in.

21 And, in fact, we would just use raw milk, and we
22 rarely use just raw milk. If you would just use
23 raw milk in our plants, I would say that our fat
24 recoveries would probably be south of
25 90 percent, just raw milk coming out of a cow.

1 Q But you don't do that?

2 A No, because the other sources, at least for the
3 most part, are available economically.

4 Q What is the -- there have been two witnesses who
5 gave some idea of what the selling price of whey
6 cream is. By the way, is that FOB the plant? I
7 take it that this cream buyer picks up the --

8 A No, our LeSueur whey cream we haul ourself. And
9 our Jerome whey cream, we -- they pick it up and
10 they pay for the freight. It's all inherent in
11 the multiplier, any multiplier there might be,
12 and it varies times of year. And, as I said, it
13 gets harder and harder to sell whey cream
14 because nobody wants it. It can be anywhere
15 from flat market to just over it, so if the
16 butter market's a buck ten, you may get a buck
17 ten a pound of fat. And there's other times of
18 the year you may get 1.08. It's subject to
19 supply and demand, and, as I said, the buyers
20 have lessened, so you have less market control.

21 Q There's a rather modest size cheese plant in
22 Iowa that testified they're getting 1.14 over --

23 A Yeah.

24 Q -- FOB their plant. Can you do that good?

25 A No. And I would imagine they're close in

1 proximity to whoever is processing that whey
2 cream. I mean I don't know that, but I would
3 imagine that.

4 Q Well, they're buying it FOB the plant.

5 A Okay. Well, the alternative, that buyer that's
6 paying 1.14, his alternative might be to drive
7 up to LeSueur, Minnesota, and he knows what that
8 freight is, so he's saying I'd rather go to, I
9 think it's Twin County, I'd rather go there
10 because they're closer.

11 Q But you deliver some too?

12 A We deliver some.

13 Q You get 1.14 for that?

14 A No, nowhere near that. And we deliver it
15 because we happen to ship milk from Idaho to
16 Minnesota every day and we take it back on a
17 truck and drop it in Nebraska. In fact, I had
18 to offer that, otherwise the price would have
19 been a lot less.

20 Q Does Grassland have a butter plant in Nebraska?

21 A Yes. Well, they bought their competitor. The
22 two biggest -- the biggest bought the second
23 biggest.

24 Q So they've got one in Nebraska and one in Idaho?

25 A No, one in Utah.

1 Q And of course in Wisconsin?

2 A Yep, Greenwood.

3 MR. BESHORE: Thank you.

4 MR. DAVIS: Thank you, Marvin.

5 JUDGE PALMER: Yes, sir. You might want to
6 give your full name. I don't think we have your
7 appearance at this hearing. We had it in the
8 previous one.

9 CROSS-EXAMINATION,

10 QUESTIONS BY MR. DENNIS SCHAD:

11 Q Good afternoon. Dennis Schad, S-C-H-A-D. I
12 work for Land O'Lakes out of Carlisle,
13 Pennsylvania.

14 Good afternoon.

15 A Good afternoon, Dennis.

16 Q Just a couple questions. You have a plant in
17 Jerome, Idaho?

18 A We do.

19 Q And Idaho is no longer -- the milk in Idaho, I
20 guess, would normally be no longer under a
21 Federal Order; would that be correct?

22 A That's absolutely true. It's amazing we still
23 are alive.

24 Q I'm just curious, how do you price producer milk
25 in the absence of Federal Order, you know, just

1 generally speaking?

2 A We do it based on what products we make, end
3 product pricing, cheese yield formula.

4 Q Of protein, butterfat, other solids?

5 A No, we know what the cheese yield should be out
6 of a certain test milk, we know what the cheese
7 market is, and we price it according to that.

8 Q Okay. A question, and, again, answer it whether
9 you wish to do or not. There was a -- Cornell
10 last year, I guess, did a survey of plants among
11 cheese plants. Was your Idaho plant included in
12 that?

13 A Yeah, I believe it was, and -- I think both our
14 LeSueur and Idaho plant was.

15 Q Just curious what your opinion would be --

16 A I don't know that Mark put all that data in
17 because I think it was a regulated -- I think he
18 had to only select the regulated plants. I
19 could be wrong, but I think -- could he do them
20 all? Okay. I know we talked about that, Mark
21 and I, when he was in LeSueur, and I guess I
22 could have followed up better on that, but I
23 thought he was going to keep that out, he just
24 did it for the exercise.

25 Q Do you have an opinion whether a non-Federal

1 Order plant should be included in a Federal
2 Order make allowance survey?

3 A I have an opinion that there should be no
4 Federal Orders, so.

5 Q Okay. Given that, do you have an opinion to my
6 question?

7 A I think there should be no Federal Order.

8 MR. SCHAD: Thanks.

9 JUDGE PALMER: Questions? Mr. Yale.

10 CROSS-EXAMINATION,

11 QUESTIONS BY MR. BENJAMIN F. YALE:

12 Q I want to follow up a question about cheese
13 yield. Is this a -- can you describe how you do
14 that, is that priced every day on the amount of
15 the components of the milk delivered by the
16 farmer or is it on an average for the month
17 delivered by the farm?

18 A We do it -- when we test milk, which is I think
19 the only legal way to do it, we do it based on
20 pounds of components.

21 Q Every day?

22 A Every pickup.

23 Q All right. Do you determine -- is the yield --
24 your cheese yield formula, is it something that
25 is designed specifically for the milk that's

1 delivered by that farm or do you just have a
2 general yield, like, for example, 10.1 cents
3 times the CME price minus so much? How do
4 you --

5 A It's based on a Van Slyke. It's proprietary,
6 but it's based on, you know, the Van Slyke that
7 I'm sure you're very familiar with.

8 Q Right. So you have -- and you have an implied
9 butterfat recovery and a casein to protein in
10 that that you decide -- it's proprietary, I'm
11 not going to ask for it.

12 A Yeah, and I would say that no matter what you
13 want to do -- what you do with fat recovery,
14 casein recovery, other solids recovery and then
15 moisture, those four components are what matter
16 in the yield. And they all can be -- one can be
17 inflated, one can be deflated, and at the end of
18 the day, your algebra gets you to the same spot.

19 Q Right. And the same thing between -- you can
20 even make some adjustments in the make allowance
21 to cover or mask what you did in the rest of the
22 algebra --

23 A I don't use the term make allowance. We call it
24 an offset.

25 Q Offset, okay.

1 A Because I golf with dairy farmers a lot, make
2 allowance makes their temperature go up, so I
3 say offset. And, again, if we get rid of the
4 Federal Orders, Ben, we don't have to worry
5 about make allowance.

6 Q That's a wonderful thought.

7 A I agree. Seems we agree.

8 Q I wish we could have that discussion, but we're
9 in a different environment today.

10 A Ask me when it's Miller Lite time.

11 Q A couple of them.

12 A A couple of them.

13 Q The question I just want to -- I'm trying to
14 come back and -- let me just set up a preface so
15 that you can understand the question I'm coming
16 from.

17 Over the years, as you can imagine, I've
18 seen a fair number of milk checks and milk
19 pricing formulas for people to buy either milk
20 from farms or cooperatives, okay, and some of
21 the cheese yield formulas that I have seen, and
22 it seems to be more common today within the
23 larger producers, is that each day milk comes
24 into the plant and it's tested for fat, it's
25 tested for protein, and based upon that

1 Van Slyke formula that's been established as the
2 basis for pricing the milk, the yield of that
3 particular load is computed, because from load
4 to load, as you know, there's some variations in
5 the fat and the protein, and at the end of the
6 month it's all added up and that's what the
7 producer receives, less or plus his offset.

8 A Exactly.

9 Q Okay. Do you have any positive offsets?

10 A Certainly happens.

11 Q Okay. For volumes and --

12 A Are you getting off your question, because I'm
13 simple. You lose me if you get off the
14 question.

15 Q No, I'm going to come back to the setup, but I
16 mean some of them do it on a load basis, some of
17 them will do it in total for the whole month,
18 they'll look at the total amount of milk that
19 came from this farm and they'll say okay, his
20 butterfat was 3.7, this is the pounds of fat
21 that he brought in, this is the protein, you
22 know, and then using your yield with your
23 Van Slyke formula that you've used with your
24 proprietary information, this is what it's
25 worth, I'll pay him that, plus or minus the

1 offset, based on the load.

2 A What we do is every pickup we test fat, protein,
3 other solids. We take that times the weight of
4 that pickup based on our scale, we get the
5 pounds. We add up all those pounds, fat,
6 protein, true protein, other solids. At the end
7 of the month we have so many of each of them.
8 We divide that into total milk pounds, and
9 that's the percent --

10 Q Okay. So you use --

11 A -- that goes into the cheese yield, so we use a
12 weighted average total.

13 Q And that cheese yield is, in a sense, custom for
14 each producer based upon the components that
15 they deliver. I mean it's not an average. I
16 mean every producer gets whatever -- they're
17 basically paid on components?

18 A They're basically paid on components.

19 Q All right. Now, you mentioned this idea of
20 scale weights. Do you pay producers on the
21 scale weights at your plant?

22 A For the most part. We have a couple -- in Idaho
23 there are mostly silos, so they don't have
24 sticks, so in Idaho we mostly do scale weights
25 because there's no other way to measure the

1 milk. In Minnesota we do bulk tanks, and then
2 we compare that to a meter we have at our plant
3 because most of those have sticks.

4 **JUDGE PALMER:** I'm lost on the silos. What
5 is this, an aboveground silo, like a corn silo,
6 they pump the milk up into it?

7 **MR. DAVIS:** They pump it into it, yeah.
8 And it doesn't have a device on it to measure.

9 Q The farms that have the silos at the farm, they
10 also -- most of those also have their own scales
11 for testing their own components coming in and
12 coming out?

13 A And their feed components, yeah.

14 Q So they'll measure that truck coming in, they do
15 their own weight at the farm, and then you do it
16 at the plant?

17 A Some of them -- most of them don't watch that
18 because ours -- we have certified scales and
19 they -- just as long as they're certified
20 scales, they understand that -- you know, you're
21 going to start chasing things around when you're
22 looking at two scale weights.

23 Q So under your unregulated area, there's no
24 farm-to-plant shrink that's computed into the
25 pricing; you pay just what is delivered to the

1 plant?

2 A Delivered to the plant, yep. We do have a
3 little shrink because we do have a few bulk
4 tanks left, but it's a small number compared to
5 the Midwest.

6 Q Do you -- this formula that you pay your
7 producers, do you publish that or make it
8 publicly available at all?

9 A No. Our producers, when we have discussions,
10 understand it, I believe. But, again, there's
11 algebra to it and there's things you can
12 manipulate internal of it that can offset one or
13 the other.

14 Q Right.

15 A And I've seen a multitude of cheese yield
16 formulas and one guy will give 93 fat recovery
17 but casein recovery will be 80 or his moisture
18 will be 36. It's just -- it's manipulating
19 algebra.

20 Q Looking at what the -- the type of components
21 that come in and trying to come up with an end
22 result, however you want to do it?

23 A Yeah.

24 Q Does the computation of that yield show up on
25 the check stubs of the producers?

1 A Yeah, for their individual yields, yeah;
2 individual tests, yep.

3 MR. YALE: Very good. I don't have any
4 other questions.

5 JUDGE PALMER: All right. Any Redirect?
6 No.

7 You're excused, sir. Thank you.

8 MR. DAVIS: Thank you.

9 JUDGE PALMER: Off the record. I guess we
10 ought to take a break. Let's take a five-minute
11 recess.

12 *(At this time a recess was taken.)*

13 GREG DRYER,
14 having been first duly sworn in by the Judge,
15 was examined and testified under oath as
16 follows:

17 JUDGE PALMER: All right. On the record.
18 Mr. Dryer is sworn. Go ahead.

19 DIRECT EXAMINATION,

20 QUESTIONS BY MR. STEVEN J. ROSENBAUM:

21 Q Mr. Dryer, you have provided a prepared
22 statement; is that correct?

23 A I have, yes.

24 Q Which has been made available on the USDA Web
25 site for several days now; correct?

1 A Correct.

2 MR. ROSENBAUM: Your Honor, we'd ask that
3 to be marked as an exhibit.

4 JUDGE PALMER: That's going to be
5 Exhibit --

6 MR. ROSENBAUM: 40, I believe.

7 JUDGE PALMER: We'll mark it as 40. I'll
8 take your word for it. It's here someplace.
9 Oh, here it is. It is 40.

10 *(Thereupon, Exhibit No. 40 was marked for*
11 *purposes of identification.)*

12 Q Could you please read the statement.

13 A Very good. Now that I'm under oath, I'm happy
14 to see my wife's not in the audience. I don't
15 want to make the same mistake that Mr. Roetlin
16 made this morning of being so charming as to
17 encourage lots of questioning from people, so I
18 won't do that.

19 This testimony is submitted on behalf of
20 Saputo Cheese USA, the U.S. division of Saputo
21 Inc., a publicly traded, international, dairy
22 and grocery products manufacturer and marketer.

23 I'm Greg Dryer, Executive Vice President of
24 Administration and Services for Saputo Cheese
25 USA Inc. I've been directly employed in the

1 U.S. dairy industry for more than 25 years in a
2 variety of roles. In my current role, my
3 responsibilities include procurement of milk for
4 all of the company's U.S. manufacturing
5 facilities extending from coast to coast.

6 My purpose here principally is to testify
7 in support of the positions presented by
8 Dr. Robert B. Yonkers on behalf of the
9 International Dairy Foods Association, our
10 primary U.S. trade association. We have several
11 specific statements that supplement the
12 conclusions of IDFA and one which represents the
13 opinion of our company individually.

14 Complexity of the System.

15 We oppose on principal any proposal that
16 adds undue complexity to a system that already
17 exceeds the capacity of most constituents'
18 comprehension. Progress towards streamlining
19 and simplicity should be considered prior to the
20 adoption of any specific proposal.

21 Make Allowances.

22 Testimony at last year's make allowance
23 hearings substantiated significant manufacturing
24 cost increases that have taken place since the
25 previous make allowances were established.

1 Processors do not have the ability to recoup
2 these cost increases under the current system.
3 The recent interim decision appears to have
4 largely overlooked these facts. Establishment
5 of a floor or market clearing manufacturing milk
6 price enables the market to adjust when prices
7 are too low by the payment of premiums above the
8 floor. Establishing too high a minimum price
9 based on unrealistic manufacturing cost data can
10 permanently damage the industry's
11 infrastructure. That generally describes what
12 has in fact been taking place in the industry
13 over the past several years. It's essential for
14 USDA to review and update cost information to
15 the most recently available in order to sustain
16 a viable market for manufacturing milk. The
17 State of California updates cost information on
18 a frequent (generally annual) basis and responds
19 with hearings and decisions in a timely manner.
20 USDA should meet or exceed the California
21 standard.

22 USDA should not arbitrarily and selectively
23 decide which costs to include or exclude. For
24 example, in the recent Make Allowance Interim
25 Decision, USDA chose to include cost data from

1 the California survey for cheese but then
2 excluded the whey cost data. These are joint
3 products whose costs are inextricably linked.
4 It is wrong to include just one or the other.
5 If one is included, then both should be included
6 and vice versa. We support utilization of all
7 the California cost data.

8 CME versus NASS Survey.

9 Albeit not by design, the linchpin of the
10 U.S. dairy industry is the Chicago Mercantile
11 Exchange Cheddar Block Market. That market and
12 its predecessors, despite years of disparagement
13 for thinness of trading and susceptibility to
14 manipulation, remains the basis for the majority
15 of cheese pricing in the United States.

16 The NASS survey was mandated to ensure that
17 the value of cheese which serves as the
18 principal factor in establishing milk prices is
19 representative of a significant percentage of
20 all cheddar cheese sold. It does absolutely
21 nothing to alleviate underlying reservations
22 about the vulnerability of the block market. It
23 simply confirms the fact that industry generally
24 follows the block market with their pricing
25 practices. It is, however, evident that to some

1 degree the NASS survey has been successful in
2 deflecting attention from, and defusing the
3 level of disgruntlement with, the cheddar block
4 market.

5 Given that there is no obligation to do so,
6 then why do processors continue to cling to this
7 block market based pricing practice?

8 Because they always have. It's their
9 longstanding tradition.

10 Because they rely on it to correlate to
11 some degree with their principal cost, that of
12 raw milk.

13 Because it provides customers with a basis
14 of comparison between suppliers and with
15 published, open-market, commodity values.

16 Because experience has shown that
17 unilateral attempts to depart from the practice
18 have characteristically ended in dismal failure.

19 Because the industry -- finally, because
20 the industry is precluded from discussing the
21 issue due to antitrust implications.

22 Employing the NASS survey as a pricing base
23 addressed certain concerns regarding end product
24 pricing but created new ones. We now have the
25 issue of circularity. Cheddar manufacturers'

1 attempts to recover rising costs with price
2 increases are automatically offset by higher
3 milk prices. Furthermore, price increases
4 implemented by cheddar manufacturers relative to
5 the block market narrow the disparity between
6 the NASS cheese price and the block market,
7 resulting in compressed margins for makers of
8 other cheeses.

9 The NASS survey has produced another
10 unwelcome side effect known as "the lag." The
11 built-in time delay or "lag" in collecting and
12 reporting price data disrupts the correlation
13 between prices based on the current block market
14 and milk costs derived from cheese prices from
15 several weeks in arrears. This often puts
16 cheese companies in the unenviable position of
17 selling cheese on declining prices while at the
18 same time paying milk prices that may in fact be
19 rising.

20 Finally, with the introduction of the NASS
21 survey came the inclusion of both block and
22 barrel cheese in the combined NASS cheese price.
23 An arbitrary three cent figure was added to the
24 barrel price to arrive at a supposed block
25 equivalent price. Others have or will testify

1 to the unfairness of this three cent barrel
2 addition, especially after accounting for
3 38 percent moist adjustment. From our
4 perspective, we do not make barrel cheese. When
5 the market becomes inverted between blocks and
6 barrels (as it has so often recently) we see an
7 increase in our cost of milk with no mechanism
8 in place for us to recover it.

9 Our first preference is for a system that
10 allows us to purchase milk at a price that is
11 fair to producers and, after converting that
12 milk efficiently into the desirable products,
13 provides both a good value to our customers and
14 a reasonable return to our owners, many of whom
15 are our own employees. We observe the futures
16 market with great interest and wonder whether
17 ultimately there could be a similar auction
18 market for current milk where large numbers of
19 buyers and sellers come together to arrive at
20 prices that reflect current market conditions.
21 Such a market could establish the value of milk
22 for all of its alternative uses - not just
23 current cheddar in the form of blocks and
24 barrels. Until that is feasible, we prefer
25 pricing similar to that employed by the State of

1 California: End product pricing based on as
2 current a block market as possible that would
3 eliminate circularity, the block/barrel
4 controversy, and the dreaded "lag." The NASS
5 survey could be maintained as an independent
6 verification that the block market continues to
7 fairly represent the current market value of the
8 commodity cheddar.

9 Failing that, we would defer to the will of
10 the majority of our associates who prefer to
11 maintain the current NASS survey, work to lessen
12 the "lag" impact, improve the accountability,
13 and eliminate the three cent barrel price
14 adjustment.

15 We would support any initiative undertaken
16 by the Government to assist the industry with
17 the migration away from milk prices derived from
18 end product values to one where a fair value is
19 established for the price of milk based on the
20 supply and demand for it. End product prices
21 could then be established by the processor after
22 due consideration of cost, competition, and
23 value. To decouple milk cost from end product
24 prices, however, without first enabling the
25 industry to extricate itself from block market

1 based pricing, would be a great injustice.

2 Other Solids or Whey Factor.

3 None of the proposals before USDA today
4 addressed the critical problem confronting the
5 processing sector relative to the Class III
6 other solids or whey factor. I would be remiss
7 to leave here today without sounding the alarm
8 about the economic hardship it is inflicting and
9 will continue to inflict on cheese
10 manufacturers. The presumed value to be
11 recaptured by the Class III formula with today's
12 unprecedented whey market is well beyond reason,
13 especially for smaller companies that have
14 neither the scale nor the capital to justify
15 whey processing facilities. Without some type
16 of corrective action, we'll likely experience
17 significant fallout and accelerated
18 consolidation in what has been the largest
19 outlet for U.S. milk.

20 Q Does that complete your statement, Mr. Dryer?

21 A Yes, it does.

22 **MR. ROSENBAUM:** At this point I'd like to
23 ask that Exhibit 40 be entered into evidence.

24 **JUDGE PALMER:** Any objection? It's
25 received.

1 (Thereupon, Exhibit No. 40 was received
2 into evidence.)

3 Q Mr. Dryer, maybe we'll just have you elaborate a
4 little on the last point, if we could, in your
5 testimony about the whey situation.

6 The current formula assumes that a cheese
7 maker, for example, is able to extract a certain
8 amount of money in the marketplace for dry whey;
9 correct?

10 A Correct.

11 Q And in your experience, is that reflective of
12 the reality that you're facing?

13 A I think the incorporation of the whey factor was
14 well intentioned, in that it was acknowledging a
15 value for by-products, products other than
16 cheese, in the operation of cheese facilities,
17 and I think it was viewed as probably the lowest
18 common denominator type of market to base the
19 factor on, but what's happened is the rise in
20 the base commodity market has been
21 disproportionate with the value of other
22 alternative by-products that cheese
23 manufacturers make, and because these businesses
24 are so capital intensive, you have to make a
25 choice up front as to which types of products

1 you're going to manufacture when you invest that
2 capital.

3 Most manufacturers have viewed higher ended
4 whey products as providing a better long-term
5 return, so they've oriented in that direction
6 and are unable to make dry whey because of the
7 volume of solids. In a dry whey facility, you
8 need very large driers and it's a different
9 process altogether, so a lot of people are
10 really suffering that don't have the ability to
11 make dry whey, or even dry whey people I talk to
12 are having a hard time recouping as much value
13 as what's presumed in the formula.

14 And when you look at smaller manufacturers
15 like in Wisconsin who are selling their whey as
16 a liquid by-product, maybe it's concentrated to
17 some degree, they're typically getting paid some
18 percentage of the market, and yet the milk
19 formula's assuming a hundred percent of the
20 market increase above the make allowance is what
21 they're making, and they're not, so it's putting
22 the squeeze on cheese manufacturers.

23 Q Now, there's not a specific proposal before us
24 today to adjust the whey -- the use of dry whey
25 as the assumed product; correct?

1 A That's correct.

2 Q But you have testified to a generalized desire
3 on your part that make allowances be set as
4 minimum prices and they not unduly enhance the
5 value; correct?

6 A Absolutely.

7 Q And is this the kind of concern that you have
8 that drives -- drives that desire?

9 A Right. And, you know, I think a good
10 representative of that was this morning with
11 Mr. Roetlin, who's making liquid whey products,
12 and you could hear from his testimony the
13 economic squeeze that he's feeling.

14 Q And just to be clear about this, the formula
15 assumes that you're going to be making dry whey
16 and therefore pays prices -- assumes you're
17 obtaining the value in the marketplace of dry
18 whey, when in fact right now the value of dry
19 whey is substantially in excess of the
20 alternatives that, in fact, many people are
21 producing with their whey; is that right?

22 A That's correct. And that's one of the problems
23 with trying to regulate the way we are. You
24 have to anticipate changes that take place in
25 the marketplace, all these other alternatives,

1 and it's a very difficult thing to do.

2 MR. ROSENBAUM: That's all I have,
3 Your Honor. He's available for
4 Cross-Examination.

5 JUDGE PALMER: Questions? Yes, Mr. Yale.

6 CROSS-EXAMINATION,

7 QUESTIONS BY MR. BENJAMIN F. YALE:

8 Q Good afternoon.

9 A Good afternoon.

10 Q I want to follow up on the questions that
11 Mr. Rosenbaum asked about the whey issue, and
12 I'm glad that you've brought that up in the
13 record, although unfortunately we're not -- we
14 don't have proposals out there to address it,
15 but I have some questions that as a person in
16 the industry, that maybe you can answer.

17 There's no doubt that, you know, when you
18 go through the process of producing cheese, one
19 of the things you get at the end of it is a whey
20 product; whether it's an acid whey or a sweet
21 whey, there's a whey out of cheese; right?

22 A Correct.

23 Q Okay. Now, I'm going to make cheese, whatever,
24 and I got this whey product. What are my
25 options as a cheese maker?

1 A Well, generally today -- well, there's a wide
2 variety.

3 Q That's what I'd like to cover, if you could.
4 Just kind of give me the ballpark.

5 A Well, you know, that part of the cheese business
6 is very sensitive to scale, where -- I think you
7 can be a smaller cheese manufacturer and be
8 relatively efficient, but when it comes to whey
9 processing, scale is very important. So a lot
10 depends on what your scale of whey generated is
11 or if you have the ability to buy whey from
12 other manufacturers in an area, although
13 transportation of whey is very inefficient, but
14 typically people make dry whey, although there
15 hasn't been a lot of orientation towards that
16 direction in recent years, or you may filter the
17 whey and make various forms of whey protein
18 concentrate, up to and including whey protein
19 isolate, and then you're left with the permeate
20 stream or the lactose stream, which you talked
21 about, and there investing money in processing
22 is a risky enterprise because a lot of time the
23 value in that product is below the costs to
24 manufacture it. Recently that's turned around
25 to be not the case. It's very high value today,

1 but it's a temporary situation. To make a
2 decision to invest millions of dollars in
3 processing for that and taking the market risk
4 is something that's beyond many people's
5 capability.

6 Q What -- you say scale. Do you have a ballpark
7 number you think that you ought to be reaching
8 to -- before it becomes --

9 A No, I guess I wouldn't have a rule of thumb,
10 but, you know, the bigger the plant, the better
11 off you are because you have no transportation
12 costs in the whey that you generate on site.
13 There's a big savings in that compared to people
14 who --

15 Q What are the standards for whey? I mean are
16 there any real standards for whey, I mean in
17 terms of composition and the like, or is that
18 something that the marketplace dictates and pays
19 accordingly?

20 A Well, there's standard of identity for whey
21 protein concentrate, 34 percent, you know, that
22 has criteria. I'm not familiar whether -- you
23 know, there are different standards to different
24 whey products.

25 Q Okay. The difference -- let's talk about the

1 whey protein concentrates. There are -- the dry
2 whey is just simply taking the retentate out of
3 whatever process and just drying that, RO or
4 whatever, you get as much water out and then you
5 just dry it down to a powder of what, about
6 97 percent or something; have I got that right?

7 A Right.

8 Q So whatever it is, it is, and that's sold as a
9 dry sweet whey?

10 A Right.

11 Q When it comes to the concentrates, there's --
12 you got WPC 40 -- or 34 and -- the common ones
13 are what? That, and what are the other --

14 A 34 we heard this morning; 50, 55, and then
15 typically 80 is a very common product, and then
16 once you get above 90, you get into the
17 isolates.

18 Q That's into the isolates. So let's talk for a
19 moment about the concentrates. You understand
20 what I mean by the term arbitrage, ability to
21 move, you know, a commodity to a commodity or
22 something?

23 A Uh-huh.

24 Q Is there an arbitrage between the WPC 35 or 34
25 and the 40s and the 80s or are they two separate

1 markets that really don't --

2 A Well, it's interesting that you raise that point
3 because there's a difference in the capability
4 to produce the product and, yes, there's
5 different markets that these products are sold
6 into, so a typical Wisconsin manufacturer,
7 specialty manufacturer that wants to make cheese
8 may have a salesperson, may have the plant
9 manager sell the cheese, is now forced with
10 having to get into the whey business, and the
11 market is entirely different. The type of
12 salesperson, the type of people you're dealing
13 with are totally different than what they are
14 with concentrating in the cheese business, so
15 you have to make choices, and the more
16 sophisticated the product, the more
17 sophisticated the buyer that you're having to
18 deal with, so typically you have scientific
19 people dealing with scientific people, you know,
20 on a technological level with these customers,
21 so it's dramatically different.

22 Q What about the difference between, say, WPC 34
23 and WPC 80, is there a wide difference in that
24 market as well?

25 A You know, I mean the majority of the products on

1 the 34 arena may be feed oriented, where the
2 higher you go, they're food oriented.

3 Q Okay. That was my next question. They have
4 different -- completely different markets?

5 A They can, you know, although they can be
6 similar.

7 Q And then the WPIs, the whey protein isolates,
8 those are very much a specialized market,
9 different from the others?

10 A Nutritional products, you know, health-oriented
11 products, bars or drinks, things like that.

12 Q And that's an issue, this issue of -- and
13 there's a wide disparity of the return to the
14 plant for the same volume of whey -- fluid whey
15 that comes into that process and whatever
16 product they choose. Today I think we are
17 saying there's a wide disparity in the end value
18 of the products that come out at the other end;
19 is that what you're saying?

20 A Yeah, and, you know, because if you make dried
21 whey, all of the solids are going into your
22 finished product which you're selling and
23 getting a higher return for. When you make
24 these other products, you're separating streams.
25 Most people are oriented towards the protein

1 stream. Some people are not oriented towards
2 putting a lot of processing into the lactose
3 stream and therefore aren't recovering much
4 money from that stream, whereas if they were
5 drying whey, they'd be getting a higher return
6 for that, so, you know, things like that have
7 happened.

8 Q Do you have an estimate of the difference in the
9 values between the higher -- well, right now
10 what is the highest value whey protein that --

11 A I think if you look at it on a per pound of
12 protein basis, dry whey today is probably valued
13 higher than any of these high-end products, you
14 know, and it changes from week to week,
15 obviously, as markets change.

16 Q But it takes more money to make the higher end
17 products as opposed to the --

18 A I would say that's typically true, although it's
19 not cheap to produce dry whey either. It
20 requires a big drier.

21 Q So you've got plants out there that have no whey
22 processing at all, you have some that are
23 producing the simple sweet whey, some that are
24 producing some whey protein concentrates, some
25 who are producing WPis, some with mixes of all

1 of that, some that are dealing with the lactose
2 and some that aren't; right?

3 A (Witness nodded head.)

4 Q There is a potential added value, though, to the
5 plant for those products; is that correct?

6 A Much of the time.

7 Q Right.

8 A At times it can be a cost.

9 Q Right. Well, that's true. So the question
10 then -- and historically it was a cost until
11 recently right?

12 A Correct.

13 Q Okay. So the question comes how then do you --
14 how does the Department, how do we come up with
15 a methodology to, on the one hand, have that
16 added value, whatever it is, available to
17 producers, but at the same time not create
18 the -- the issue that you're talking about with
19 the plants, that it's an issue that you feel
20 needs to be discussed, do you have any ideas how
21 that could be addressed?

22 A No, and I think that's what I was trying to get
23 at in my statement. When we try to regulate
24 these things into the minutia that we're
25 discussing here, before you were talking about

1 dry matter and talking about fat recoveries, and
2 the more you get into it, the more complex it
3 becomes. I was relatively interested when
4 people started talking about a different
5 methodology entirely for price discovery of milk
6 and someone floated the idea of something based
7 on futures or -- you know, I think we need to do
8 something radically different ultimately so that
9 we don't get caught up into this regulatory
10 minutia.

11 Q So, realistically, the issue of dealing with
12 make allowances in and of itself is not an
13 answer to the problem. It might provide some
14 relief to the symptoms, but it's not an answer
15 to the problem with the whey; is that --

16 A Yeah, and I think my perception of what's
17 happening here is because, as I said, the block
18 market is the linchpin for everything, that's
19 basically determining the value of milk, there
20 may not be enough money on the table there to
21 sustain both processors and producers at times,
22 and I think that's what's been encountered in
23 the last year, so then we -- the producers and
24 processors are at odds because there's not
25 enough money to sustain us both.

1 Q I don't know if you were here today, I think
2 Mr. Beshore asked that question, is the problem
3 that we should be paying less for the milk or is
4 it that we should be getting more out of the
5 market, and I think the answer for both of us I
6 guess would be if we got more out of the market,
7 we might not be having the fights that we have.

8 A That's true, but if the market is the market --

9 Q I understand. We're there, because I want to
10 talk about that in a second. You also talk
11 about this issue of suggesting that in light of
12 the pros and cons of the CME and the NASS as it
13 stands today, the preference would be to use the
14 CME as the -- and I'm trying to paraphrase this,
15 so please correct me, and I'm going to ask the
16 question about how you agree and how you
17 disagree, but to use the CME as actually setting
18 the value of the milk and then let the NASS
19 provide that necessary safeguard to insure its
20 validity of doing that; is that a fair
21 statement?

22 A That's right. I guess my statement is implying
23 or saying that we prefer the California system,
24 which is based on the CME platform.

25 Q And they do an adjustment or two, I think, to

1 theirs, do they not?

2 A Well, there's a factor in there to account for
3 the fact that product has to be transported back
4 to populous.

5 Q Now, you also state in here, and, again, this
6 is -- I think we're all here trying to solve the
7 problem. We have different views on where we go
8 and stuff, but you mention this idea that the
9 CME because -- right now because all of the
10 reasons you mentioned, institutionalized and
11 it's the way we've always done it and, you know,
12 there's too much market pressure to keep us from
13 doing it, we all price on that CME price, but
14 you can't talk about solutions because it
15 becomes an antitrust issue; right?

16 A (Witness nodded head.)

17 Q Now, you're aware that discussion of those
18 issues in a hearing such as this is not a
19 violation of the antitrust. I don't know if you
20 know that or not.

21 A No, I didn't.

22 Q I'm not going to give that. You might want to
23 ask your own lawyer for that advice, I mean.
24 But, you know, is that a situation where we
25 should be asking the Department to allow such a

1 wide open hearing to look at those alternatives
2 in order to find that?

3 A I certainly would advocate something like that.
4 You know, I think we've been entrapped in this
5 system for so long and there's really no way out
6 on an individual basis. To me it's an industry
7 issue. I'd like to see us get away from block
8 market based pricing. And I attended a seminar
9 at the CME and the question was raised and the
10 CME people said we don't want you to price your
11 product off our markets, you know, and then it
12 comes down to everybody looking at each other,
13 saying well, how do we get away from this.

14 Q Why would we need your market if we're not going
15 to price off of it. That would be my question.

16 A Well, it's -- I guess we need some indication
17 of, you know, the current market.

18 Q Have you looked at any concept of any kind of
19 futures trading of cheese?

20 A You know, I got excited when that idea was
21 floated, because one of the problems we have,
22 both producers and processors, when you're
23 making a very perishable product, it's difficult
24 to have a lot of backbone when it comes to
25 negotiating a price when you know your product

1 will be worth nothing in a matter of days. And
2 with futures, people are looking forward, and
3 there you're seeing producers come to the table
4 and indicating what they're willing to produce
5 milk for and buyers indicating what they're
6 willing to buy it for, which I find intriguing.

7 The problem is -- and the problem was
8 pointed out to me by other associates, that as
9 far as current conditions are concerned, you
10 need to have a very current market so that
11 products will clear. If you have a price that's
12 unrealistic, you have no guarantee that you'll
13 be able to move the product, so I mean that's
14 the challenge in that kind of thinking, but I
15 think it has some appeal, some variations.

16 Q Do you see that, though, as a trading off of the
17 futures of cheese or do we look at a trading off
18 the futures of milk or of milk components, or do
19 you do both?

20 A Actually, I was thinking of it in terms of what
21 we have today, which is Class III milk.

22 Q Right.

23 A You know, I suppose it would make sense to look
24 at the components of the milk, but, again, you
25 know, one of my comments was we want to try to

1 avoid complexity. We're so embroiled in all
2 this complexity, it's overwhelming I think for
3 most people.

4 Q Of course, one of the problems with the CME is
5 it's a cash market, you have to accept delivery
6 or be able to deliver product, and that reduces
7 the number of potential players.

8 A Right.

9 Q Do you see that as a problem in terms of the
10 value of that market?

11 A Yeah, I mean I -- the CME is -- it's a thin
12 market. It doesn't -- you know, we're selling
13 almost ten billion pounds of cheese in this
14 country today, and I can't off the top of my
15 head quantify the amount that that market
16 represents, but it's a small fraction.

17 **MR. YALE:** I have no other questions.

18 Thank you.

19 **JUDGE PALMER:** Other questions?

20 Mr. Beshore.

21 **CROSS-EXAMINATION,**

22 **QUESTIONS BY MR. MARVIN BESHORE:**

23 Q Good afternoon, Mr. Dryer.

24 A Good afternoon.

25 Q I'd like to explore with you just a moment the

1 comments about your ultimate preference for
2 using the block market in a manner similar to
3 California perhaps.

4 And on the next to last page, unnumbered
5 page of your testimony, you indicate that would
6 eliminate the block/barrel controversy.

7 What all is involved in that block/barrel
8 controversy that would be eliminated by using
9 only blocks?

10 A Well, today we're using a NASS cheese price,
11 which is a combination of barrel cheese and
12 block -- or block cheese and barrel cheese
13 adjusted to 38 percent moisture with a three
14 cent addition, and there's some controversy as
15 to the -- you know, the moisture adjustment and
16 the three cent addition. And today we're seeing
17 barrel prices as high or higher than blocks in
18 the NASS survey and that in the CME, so a system
19 like California's ignores barrels and uses
20 strictly cheddar blocks as the basis, so to me
21 that then avoids that whole controversy. It's
22 what we had done previously.

23 Q Does the use of both barrels and blocks embed
24 risks in the system for market participants, you
25 know, such as your company that would not be

1 present if there were the use of blocks only?

2 A I guess I'm not understanding the question.

3 Q Well, when you're -- if transactions, as
4 you've -- your testimony indicates are
5 predominantly based off the block market;
6 correct?

7 A Correct.

8 Q Okay. Those are the marketplace sales of
9 finished cheese; correct?

10 A Yes.

11 Q But the price, the milk price, uses both the
12 barrel and the block. Does the use of the
13 barrels put a variation, a risk factor in that
14 for the players such as yourself?

15 A It does, and it's one that we don't have the
16 ability to hedge against, so like right now
17 barrels are adding to our milk cost, and yet
18 we're selling the majority of our products on
19 the block market, so our costs have increased.
20 It's difficult for us to go to a customer, say
21 we need more money for our product because
22 barrels are higher. That's a hard argument to
23 make. Customers are very resistant to price
24 increases in today's economy.

25 Q And I guess when that price relationship is more

1 traditional with barrels being less, you've got
2 a different kind of dynamic in the --

3 A That possibility exists, but we would prefer to
4 have a business where we can run with a
5 consistent margin instead of having to endure
6 all of these uncontrollable ups and downs that
7 we're faced with.

8 Q Would it be fair to say that having barrels in
9 the price formula in a block dominated market
10 builds in winners and losers at all times
11 depending on whether the barrel price is higher
12 or lower at a given time?

13 A I can imagine a person who makes and sells
14 barrels on the barrel market would like to see
15 his milk cost follow the product that he's
16 selling, but even for them it doesn't because
17 it's influenced by blocks, so it's kind of in
18 between. You know, it doesn't accomplish what
19 he needs and it doesn't accomplish what I need.

20 Q Do you have any information with respect to your
21 judgment as to the proportion of cheese that's
22 priced off the block market?

23 A I really don't, although we follow, and I think
24 there was testimony to the level of correlation
25 between the NASS and the block markets, and if

1 you adjust for the timing differences, it's
2 very, very high, so that to me indicates a high
3 correlation. In our own business, we sell into
4 all channels with our products and a certain
5 percentage of our business is sold on a fixed
6 price basis, but the majority is sold relative
7 to the block market.

8 Q I don't know if you've enumerated in your
9 statement, and don't repeat if I've missed it,
10 but how many plants do you have in the Federal
11 Order System and what products do you -- does
12 Saputo manufacture?

13 A We have fifteen plants in the United States.
14 Eleven of those plants receive and process milk.
15 Six of those are in Wisconsin. We have two in
16 the eastern United States and we have three in
17 the state of California.

18 And we produce a wide range of cheese
19 products. We produce Swiss cheese, bleu cheese,
20 mozzarella. No cheddar. Parmesan, Romano,
21 Asiago, ricotta, produce a cheese called
22 Lorraine cheese, which is a specialized lacy
23 Swiss type of cheese. A large quantity of
24 string cheese for the retail market. Appetizer
25 stick cheese, a wide range of cheeses. So, you

1 know, we get into all these debates about
2 regulating cheddar, and we're trying to manage
3 our business relative to what cheddar does to
4 our cost of milk and it's very complicated.

5 Q You produce no cheddar, but all your milk cost
6 is determined by the --

7 A That's right. Cheddar is dear to us because of
8 milk.

9 Q And the majority of your production is sold with
10 respect to the cheddar block market?

11 A Yes.

12 MR. BESHORE: Thank you.

13 JUDGE PALMER: Yes, sir, Mr. Smith.

14 CROSS-EXAMINATION,

15 QUESTIONS BY MR. DANIEL SMITH:

16 Q Good afternoon. My name is Dan Smith. I'm
17 representing the Maine Dairy Industry
18 Association.

19 A Good afternoon.

20 Q You indicated in your statement that the current
21 system allows for the payment of premiums when
22 the clearing price is low enough.

23 Since the component pricing system has gone
24 into effect, can you point to the time when
25 there have been over-order premiums in the

1 market?

2 A It's very typical in the upper Midwest for
3 over-order premiums to exist. There's more
4 plant capacity there than there is supply of
5 milk, so people are chasing, you know, an
6 adequate supply to run their plants.

7 And in the eastern United States, we
8 operate a plant in Vermont and another in
9 Maryland, recently milk has been less available
10 than in the past and we've seen some increases
11 there in over-order premiums.

12 To us -- you know, there's different
13 perspectives here. There's over-order premiums
14 from the perspective of a producer receiving
15 them and there's a perspective of a buyer paying
16 them.

17 To us an over-order premium is the amount
18 paid for milk that's above the Class III price,
19 so that may encompass, to some degree, a service
20 charge that goes to the cooperative for managing
21 the milk, lab tests, delivery and that kind of
22 thing, and then the other element that the
23 farmer actually receives in his check, that's
24 another thing.

25 Q And my question dealt more specifically with

1 that latter net over-order premium, so you would
2 say in the recent time in your plants in Vermont
3 and Maryland, just --

4 A There's been price pressure there because of
5 inadequate supplies, but, you know, those things
6 come and go. We do not buy milk in the U.S.
7 direct from producers, so we're not involved
8 with establishing premium programs, if that's
9 what you're getting to, protein premiums or
10 volume premiums, quality premiums. We're not
11 involved with that.

12 We're focused on our product and our
13 customers, and we leave the servicing of farmers
14 to cooperatives, who can do a better job than we
15 could.

16 Q There's currently quite a volume of unregulated
17 milk in Idaho, so with regard to your testimony
18 about trying to price off a supply and demand
19 environment, would that volume of milk at this
20 point be at all representative of supply and
21 demand in the larger marketplace?

22 A When you're saying that, are you talking about
23 price levels, when you say representative of
24 supply --

25 Q Yeah, the price level, yes, for the milk. It's

1 a new development in the --

2 A Right. And, you know, it's a cause of concern
3 because one of the things we like to have is a
4 level playing field for everybody to compete in,
5 and now that we have part of the country
6 that's -- we have different regulatory systems,
7 obviously; we have California, we have USDA, and
8 now we have unregulated areas, and everybody's
9 operating on a different basis. That's a
10 concern when you're competing on a national
11 scale for business, and even to some extent, for
12 instance, in the upper Midwest today, what I see
13 happening is people that buy their milk directly
14 from producers are, in many cases, reducing the
15 amount they're paying on the other solids factor
16 to compensate for the fact that they're not
17 making as much as it presumes they should make
18 for whey, and they're able to do that because
19 they have enough built-in premiums that they can
20 do that and still stay above the regulated
21 price. And then we're competing against those
22 people, we don't have that ability, or we're
23 competing against unregulated areas where we're
24 paying on cheese yield factors and other
25 formulas that may result in a lower cost to them

1 than our cost, so that's a concern.

2 Q So you do see that volume of unregulated milk
3 starting to have an impact on the market? It is
4 enough volume to begin to have an impact?

5 A Oh, there's definitely -- Idaho is a huge milk
6 producing state all the sudden and, you know,
7 there are people that we compete against that
8 are located there, yes.

9 Q This question may be too dense. If it is, let
10 me know, but you indicated you have some plants
11 in California subject to the California pricing
12 program and plants in the Federal Order System.

13 Given the different criteria that the two
14 programs operate under, how does your business
15 account for taking product to market on the
16 Federal Order System for the program in
17 California, number one? How do you rationalize
18 that within your business?

19 A Well, we try to pay attention to, you know,
20 continually having to update calculations on
21 which is the most efficient way to service our
22 market, so we may at one time be wanting to
23 produce and distribute more cheese out of
24 California than say the rest of our plants or
25 vice versa, but, you know, as these conditions

1 change, and they change on milk from month to
2 month, that's something we have to continually
3 look at. We see it as a strength for our
4 company to have a broad base where we're located
5 in lots of different geographies, you know, but
6 we do balance, you know, and we try to make sure
7 that our customers are accepting of product from
8 all of our plants in any region so that we can
9 switch back and forth when the economics
10 dictate.

11 Q Would you say that the dynamic between the two
12 pricing programs has more of an impact on your
13 business decisions than the imperfections you
14 described in the block market, the CME, NASS
15 reporting?

16 A Not really, because the systems have become
17 very, very similar. I mean the pricing formulas
18 are -- you know, you have the same -- the same
19 base commodity products driving the cost of
20 each. Each has a whey factor, each, you know --
21 so depending on whether markets are moving
22 dramatically one direction or another, usually
23 there's a fairly predictable measure of
24 difference between the two, unless markets start
25 moving. Then California is much more responsive

1 to current prices than the USDA is, so then you
2 might open up disparities in one way or another.

3 And it was talked about earlier, what
4 difference does it make if it balances out over
5 time. We find that a customer controls the
6 buying decision, when he wants to buy the
7 product. We as producers and manufacturers --
8 cows generate milk every day. We have to take
9 possession of that milk every day, so we're
10 producing products on a daily basis. We find
11 that our sales are stronger at times when it's
12 to our disadvantage than it is to when it's our
13 advantage, so over time it doesn't balance out
14 because the customer has the ability to take
15 advantage, because he's the one calling on the
16 phone making the order, as to when he does that,
17 so it doesn't average out, in our experience.

18 MR. SMITH: Thank you.

19 JUDGE PALMER: Any questions at all?

20 MR. ROWER: No.

21 JUDGE PALMER: Thank you, sir. We've got
22 your two witnesses done.

23 MR. ROSENBAUM: Yes, those are our
24 witnesses for the day.

25 JUDGE PALMER: Mr. Wolfe, if you'd come

1 forward, sir.

2 **BRYAN WOLFE,**

3 having been first duly sworn in by the Judge,
4 was examined and testified under oath as
5 follows:

6 *(Thereupon, Exhibit No. 41 was marked for*
7 *purposes of identification.)*

8 **JUDGE PALMER:** Mr. Wolfe has just handed me
9 his prepared statement submitted on behalf of
10 Ohio Farmers Union, and we're marking it as 41
11 for identification. Does everybody have a copy
12 of it?

13 I see there's a few over there perhaps.
14 Does anybody need a copy? Looks like it's
15 coming. All right.

16 Sir, if you would be so kind as to firstly
17 state -- really, it looks like it's pretty much
18 statistical.

19 Would you give your full name and
20 identification and who you're affiliated with.

21 **MR. WOLFE:** My name is Bryan Wolfe. I'm
22 vice president of Ohio Farmers Union, and I'm
23 representing Ohio Farmers Union today.

24 **JUDGE PALMER:** And you have a statement to
25 give, sir?

1 **MR. WOLFE:** Well, I think I should probably
2 give a little history on this.

3 **JUDGE PALMER:** Go ahead.

4 **STATEMENT OF BRYAN WOLFE**

5 **MR. WOLFE:** Back in September of 2006, we
6 submitted a proposal to USDA's AMS on Class III
7 and Class IV. February 13th of 2007 we had
8 received a letter from Mr. Lloyd Day saying that
9 our statement was not accepted.

10 On February 28th I went to Strongsville and
11 read a statement that we were disappointed, not
12 just that our proposals were not accepted, but
13 40 out of 41 proposals submitted by dairy
14 farmers and farm organizations were denied.

15 At that time I thought Mr. Stevens from
16 USDA had kind of given us the opportunity to
17 possibly resubmit our statement, because he'd
18 asked me if I wanted to make a statement that
19 day.

20 So we went back home and we called and
21 e-mailed Mr. Day again, we haven't got a
22 response from him, whether we could resubmit
23 this, so we went ahead and made some of the
24 changes that he said that were reasons why they
25 couldn't submit -- or accept our proposals at

1 that time, so what I have today is some
2 proposals that Ohio Farmers Union kind of redid,
3 and I hoped that you would put them in the
4 record.

5 **JUDGE PALMER:** Well, I'm not sure if
6 there's an objection. Is there any objection to
7 this?

8 **MR. ROSENBAUM:** I have to object,
9 Your Honor. It's not part of the noticed
10 proposals. In fact, it was submitted to USDA,
11 and USDA determined not to include it in the
12 notice, as I understand it.

13 **JUDGE PALMER:** Does the USDA have any
14 comment on that?

15 **MS. PICHELMAN:** It is not part of the
16 hearing notice, but we will not be objecting to
17 it.

18 **JUDGE PALMER:** You don't have any objection
19 to it?

20 **MS. PICHELMAN:** No. To it coming in, we
21 don't have any objection to it coming in.

22 **JUDGE PALMER:** Well, I'm not so sure how
23 it's coming in. Is it coming in as a proposal
24 or is it coming in as a --

25 **MS. PICHELMAN:** Your Honor, we don't have

1 an objection with his statement being received.

2 **JUDGE PALMER:** Okay, I understand about
3 that, but I'm just trying to see where it goes.
4 There's no proposal on the floor, I take it.

5 **MR. ROSENBAUM:** Well, page 4 contains a
6 proposal, Your Honor.

7 **JUDGE PALMER:** Let's take a look.

8 **MR. ROSENBAUM:** It looks like it's labeled
9 "Proposal" and at the bottom of the page it
10 provides a formula, and it just -- you know, the
11 whole purpose of going through this advanced
12 publication of -- is -- it's actually a legal
13 requirement, not merely a courtesy.

14 **JUDGE PALMER:** What we'll do, we'll let the
15 statement -- let him put the statement in as
16 kind of an offer of proof I guess. I haven't
17 read it, that's one of my problems here.

18 Are you also objecting to the other
19 proposals that have been made? Is that part of
20 what you're doing?

21 **MR. WOLFE:** No. No. When we were at
22 Strongsville, what we were trying to convey was
23 our disappointment that none of the -- there was
24 41 proposals submitted by farmers and farm
25 organizations and only one of those were

1 accepted into this hearing, so we feel that
2 our -- our concerns with farmers' cost of
3 production issues aren't being heard at these
4 hearings.

5 **JUDGE PALMER:** I understand. So this is a
6 specific proposal?

7 **MR. WOLFE:** Right.

8 **JUDGE PALMER:** All right. Well, I agree
9 with Mr. Rosenbaum. I don't think we can
10 consider it as such since it wasn't noticed for
11 the hearing, but I'm going to -- I've marked the
12 document as 41 and it will go along with the
13 record and we'll take it as an offer of proof.

14 **MR. MILTNER:** Your Honor, this is Ryan
15 Miltner with Yale Law Office.

16 I've tried to look at the transcript from
17 when Mr. Wolfe appeared in Strongsville. As
18 Mr. Vetne pointed out, it's not exactly the
19 easiest thing to search through, but Mr. Wolfe
20 recalls, and I happen to recall also, that when
21 he testified, the Department asked if he had
22 specific language to propose about the issues he
23 wanted to talk about, and so he's come back in
24 direct response to that inquiry from the
25 Department.

1 And I appreciate that you're going to allow
2 his testimony to be offered, but, you know, I
3 think given that he's responding to an
4 invitation of the Department, he ought to be
5 allowed to have it actually admitted, and to the
6 extent that there are comments in response to
7 it, people are certainly welcome to do so, and
8 the Department, of course, can respond to his
9 proposal accordingly.

10 **JUDGE PALMER:** Well, I mean as
11 Mr. Rosenbaum said, we have a procedure, we're
12 supposed to do these proposals in a certain way,
13 and if he makes a proposal and the Secretary
14 said we're not going to consider it, that's
15 pretty much where we are.

16 **MR. MILTNER:** Well, but, Your Honor, the
17 purpose of an administrative hearing such as
18 this, as you know, is to flesh out the issues
19 related to a topic, not to rigidly consider the
20 particular language that may be included in the
21 hearing notice.

22 Once the issue itself becomes open for
23 debate, proposals and concepts tend to develop,
24 and in this case they developed in response to a
25 question from the Department itself.

1 **JUDGE PALMER:** That may be, but I'm not
2 going to receive it. I'll let it go along with
3 the record as an offer of proof.

4 Yes, sir.

5 **MR. YALE:** Well, just an additional
6 argument. There is a process here. I mean the
7 Department says they're not going to object.
8 It's out there and it has its own value as a
9 statement vis-a-vis the proposals that are
10 there. It can be viewed as testimony as regards
11 to the officially noticed proposals the
12 Secretary's going to consider.

13 **JUDGE PALMER:** I just asked and he said no.

14 **MR. YALE:** Well, he doesn't understand the
15 sophistication of what's going on here, so. And
16 I feel awful uncomfortable, I'm sitting here
17 defending -- you know, it's really not our
18 position, it's not our proposal, but there's a
19 sense in the field that we have to establish a
20 sense, to whatever degree it is, that the
21 farmers have a voice, and he's presenting a
22 voice, and it isn't the artful, articulate,
23 legal thing that we would like to see, but on
24 the other hand, it is in response to a question
25 asked by the Department. They aren't going to

1 object to it. It can be viewed in a sense that
2 says this is how we'd like to have it and this
3 does this for us, so that when the Department
4 says okay, we're going to do this one way or the
5 other with yields, it does have at least a voice
6 out there that says well, we can't give them
7 their proposal, but we can at least address one
8 of their concerns in that because we're
9 addressing it over here.

10 I mean it has a value other than just
11 simply something that we have to take on that is
12 going to be accepted or rejected. It's -- it
13 says something to the Department, this is what
14 producers are thinking, so that the Secretary,
15 in looking at the proposals that are noticed,
16 can at least be responsive to it, and that's
17 where I think it has a value away from this
18 sophisticated -- you know, I think we got to be
19 realistic of where it would go in terms of
20 proposals. I mean I understand the rules, but I
21 just think that --

22 **JUDGE PALMER:** I'm still going to do it the
23 same way. It'll accompany the record as an
24 offer of proof, but not as a -- an exhibit
25 that -- that makes a proposal.

1 And at that point, sir, I think we've
2 concluded.

3 **MR. WOLFE:** Okay.

4 **JUDGE PALMER:** Thank you, sir.

5 **MR. YALE:** Well, can we ask questions?

6 **JUDGE PALMER:** No. No. I mean, I do what
7 I can with the situation where we're trying to
8 have something like a formalized hearing and
9 things keep changing about and I try to
10 accommodate, but there has to be a certain
11 amount of order. And if he doesn't have a
12 proposal that was noticed by the Secretary for
13 this hearing, I'm not going to hear it, because
14 I go through this almost every hearing we have
15 where somebody wants to put in a separate
16 proposal and we either shoot them down or we
17 don't, and unfortunately he doesn't have a
18 proposal, and that's where it stands. And you
19 can -- you can brief it, put it in a brief, say
20 the judge was wrong, whatever you want to do.

21 **MR. YALE:** Well, I just take again the
22 exception that we have to accommodate the level
23 of sophistication.

24 **JUDGE PALMER:** He's pretty sophisticated.
25 He understood he put in a proposal. He's not an

1 unsophisticated man. It's got nothing to do
2 with sophistication. His proposal was denied
3 when he put it forward. Now, somebody said
4 well, why don't you bring it up at the next
5 hearing, he did, we have it here, they can look
6 at it, and if I'm wrong, the Secretary can say
7 well, let's reopen the hearing and take evidence
8 on that, but at this point in time it's not open
9 to it and that's where it stays. Now, let's go
10 on.

11 Thank you very much, Mr. Wolfe.

12 **MR. WOLFE:** Thank you.

13 **JUDGE PALMER:** Who else do we have as a
14 witness today? Do we have any other witnesses
15 today? I think our next witness is probably
16 Mr. Yale, but he wants a short recess.

17 **MR. ROSENBAUM:** Your Honor, Mr. Metzger is
18 available.

19 **JUDGE PALMER:** Would you like to do it now,
20 Mr. Metzger?

21 **MR. METZGER:** Certainly, right when
22 everybody's testy.

23 **ERICK METZGER,**

24 having been first duly sworn in by the Judge,
25 was examined and testified under oath as

1 follows:

2 (Thereupon, Exhibit Nos. 42 and 43 were
3 marked for purposes of identification.)

4 **JUDGE PALMER:** Mr. Metzger is sworn. His
5 statement as such is Exhibit 42 marked for
6 identification, and then there's some tables
7 that he has in a separate document, there's
8 quite a few tables, I'm not going to go through
9 it, but the tables are Exhibit 43.

10 Is someone working with you, Mr. Metzger?

11 **MR. METZGER:** Nope, I'm flying without a
12 net.

13 **JUDGE PALMER:** You don't have an attorney?

14 **MR. METZGER:** No.

15 **JUDGE PALMER:** You may acquire one before
16 it ends, you never know. All right. I think
17 you can just start by reading from the
18 statement. I looked at it, you have everything
19 in your statement.

20 **STATEMENT OF ERICK METZGER**

21 **MR. METZGER:** Yes. Thank you, Your Honor.
22 However, I would point out that --

23 **JUDGE PALMER:** Let's keep down the noise of
24 everybody, please.

25 **MR. METZGER:** I would point out that one

1 point showing my -- shall we say my inexperience
2 with Federal Order testimony is that I didn't
3 put in a statement that this is in support of
4 Proposal 16 which was submitted by National
5 All-Jersey.

6 **JUDGE PALMER:** All right.

7 **MR. METZGER:** In addition, in the header, I
8 don't know how critical it is, but obviously
9 this is the week of April 9th, 2007, not
10 February 26th. This was originally drafted for
11 the Strongsville hearing.

12 **JUDGE PALMER:** Why don't we just scratch
13 February 26 and put in April 9, just so that
14 somebody doesn't become confused later. I'll do
15 that on the one that I have here, and I presume
16 the one that's going to be the official version
17 that the reporter has, if you do the same where
18 it says up at the top. Do you follow me?

19 **THE REPORTER:** Yes.

20 **JUDGE PALMER:** Okay. Go ahead, sir.

21 **MR. METZGER:** Thank you. My name is Erick
22 Metzger, and I serve as the General Manager of
23 National All-Jersey, Inc. (NAJ), a position I
24 have held for approximately three years. I was
25 raised on a dairy farm in Indiana, earned a

1 Bachelor of Science degree from Purdue
2 University in 1982 and an MBA from Franklin
3 University in 1999. I was employed by the
4 American Guernsey Association for ten years,
5 including five years as its CEO. I have been in
6 the Jersey organizations for the past 14 years.
7 I have testified and filed comments in
8 conjunction with previous Federal Order
9 hearings.

10 NAJ is a national membership organization
11 of over a thousand producers and other people
12 interested in supporting equitable milk pricing.
13 Approximately 30 percent of NAJ members own cows
14 other than Jerseys. NAJ's milk marketing policy
15 is to advocate for milk pricing programs that
16 will price milk based on its most valuable
17 components in accordance with their use in
18 consumer products. It is this policy that
19 compelled NAJ to submit a proposal to value dry
20 whey on a protein basis instead of the current
21 other solids basis.

22 However, in life, as the old expression
23 goes, timing is everything. In the six months
24 since the September 30, 2006, deadline for
25 submitting proposals to be considered at this

1 hearing, the dry whey price as reported by NASS
2 more than doubled from 29.65 cents per pound in
3 August 2006 to 60.05 cents per pound in February
4 2007. During the same time period, the lactose
5 (mostly) price reported by Dairy Market News has
6 increased from 33.89 cents per pound to 59.3
7 cents per pound. These unprecedented price
8 increases and price levels bring an entirely
9 different dynamic to the whey solids market.
10 Yet the underlying principles behind NAJ's
11 proposal remains sound.

12 In analyzing this proposal, the most
13 important questions to be asked are:

14 Which price series for whey products and
15 lactose is more representative of their true
16 market, the six-and-one-half years from
17 January 2000 to mid-2006, or the few months
18 since 2006?

19 Which whey solids are the most valuable
20 today and will be in the future?

21 If we were designing a formula from scratch
22 today, as opposed to eight years ago, to convert
23 the value of whey solids to producer milk
24 values, what would the ideal formula look like?

25 The definitive answers to these questions

1 are most likely beyond the predictive powers of
2 anyone involved in this hearing, including
3 myself. However, regardless of the answers, the
4 formula used for converting whey prices to
5 producer pay prices needs to be, at the very
6 least, changed to recognize the value of protein
7 in whey solids. Prices in recent months
8 indicate that the whey solids should be priced
9 on a protein and non-protein basis separately,
10 instead of both portions of whey solids being
11 valued equally, as is done in the current price
12 formula. Prices prior to last fall justified
13 whey solids being valued simply on a protein
14 basis, given that the non-protein whey solids
15 prices (basically lactose) were not much, if
16 any, higher than the cost to process lactose.

17 During the past four years, production of
18 the most -- more protein-concentrated forms of
19 whey products has increased, while the
20 production of dry whey has remained virtually
21 unchanged. Table 3 in Exhibit 43 shows that
22 from 2003 to 2006, production of dry whey has
23 increased only 1.5 percent. Production of WPCs
24 (25 percent to 49.9 percent) has increased
25 6.6 percent; production of WPCs (50 percent to

1 89.9 percent) has increased 40.7 percent; and
2 production of whey protein isolates has
3 increased 45.5 percent.

4 In addition, assuming:

5 WPCs (25 percent to 49.9 percent) average
6 34 percent protein,

7 WPCs (50 to 89.9 percent) average
8 70 percent protein, and

9 WPIs average 90 percent protein,

10 The total pounds of whey protein in WPCs
11 and WPIs have increased by 24 percent during the
12 past four years and now exceed the pounds of
13 protein in dry whey by approximately 82 million
14 pounds annually. The annual differences in the
15 amount of whey proteins processed in dry whey
16 versus the WPCs and WPIs is further illustrated
17 in Graph 3. Clearly buyers of whey solids
18 prefer products that are protein rich and
19 protein standardized with lower levels of
20 lactose. These production and buying trends are
21 evidence that whey's value lies in its protein.

22 In addition, product yields of WPCs and
23 WPIs are dependent on the protein levels in the
24 whey stream resulting from the cheese making
25 process. Higher protein milk results in higher

1 protein whey, which leads to increased yields
2 when producing WPCs and WPIs.

3 Protein is consistently worth more than
4 lactose. Dairy Market News reports monthly
5 prices for whey protein concentrate 34, (WPC 34)
6 and dry whey, which are sources of protein.
7 Dairy Market News also reports prices for
8 lactose. In Table 1, Exhibit 43, compares the
9 monthly values of these two whey products per
10 pound of protein with the value of lactose since
11 January 2000. WPC 34 is assumed to be
12 34 percent protein, while dry whey is assumed to
13 be 13 percent protein. Dividing the product
14 price by its percent protein (columns titled
15 "Protein Parity") shows the cost of buying a
16 pound of protein in that product assuming the
17 value of the non-protein solids portion of the
18 product is zero. In all cases the average price
19 based on protein parity far exceeds the average
20 price of lactose. The cost to buy a pound of
21 protein in dry whey or WPC 34 is consistently
22 higher than the price for a pound of lactose.
23 These same data are represented graphically in
24 Graph 1 of Exhibit 43.

25 Lactose purchased in whey products is more

1 expensive per pound than buying -- than
2 purchasing lactose directly. Table 1 in Exhibit
3 43 also shows the month-by-month per pound
4 lactose parity price for WPC 34 and dry whey
5 along with lactose prices. Lactose parity can
6 be calculated by dividing the product price by
7 its percent lactose. Lactose parity shows the
8 cost of buying a pound of lactose in a given
9 product assuming the non-lactose portion of the
10 product has no value. On average, a pound of
11 lactose purchased in the form of WPC 34 costs 71
12 cents more than a pound of lactose purchased in
13 dry whey. In turn, on average a pound of
14 lactose purchased in dry whey costs nearly six
15 cents more than buying lactose itself. Even in
16 the past 12 months when lactose prices have
17 increased from 23 cents per pound to 55 cents,
18 the cost of buying lactose in the form of dry
19 whey has remained higher than simply buying
20 lactose. Therefore, dry whey and WPC 34 are not
21 being purchased for their lactose because it's
22 cheaper to buy lactose directly. Again, these
23 same data are shown graphically in Graph 1 of
24 Exhibit 43.

25 Whey proteins are the preferred source of

1 protein in the dry dairy products. Nonfat dry
2 milk and dry buttermilk can also serve as
3 protein sources. Table 2 in Exhibit 43 compares
4 the protein parity prices for nonfat dry milk,
5 dry buttermilk, WPC 34 and dry whey. Both
6 nonfat dry milk and dry buttermilk were assumed
7 to be 34 percent protein. From January 2000
8 through December 2005 protein purchased in
9 WPC 34 and dry whey was less expensive per pound
10 than protein purchased in nonfat dry milk and
11 dry buttermilk. The economy of protein
12 purchased in whey products made them the
13 preferred source of protein. These same data
14 are graphed in Graph 2 of Exhibit 43.

15 Protein parity prices for dry whey and
16 WPC 34 track each other more closely than do the
17 lactose parity prices for those two products.
18 Graph 1 in Exhibit 43 shows that the lines for
19 protein parity prices for dry whey and WPC 34
20 are very close together, indicating that buyers
21 are willing to spend approximately as much per
22 pound of protein in the form of either dry whey
23 or WPC 34. On the same graph, the lactose
24 parity values for the same two products do not
25 closely track each other, and both are shown to

1 be more expensive than lactose itself. If the
2 value of WPC 34 and the dry whey was due to the
3 lactose content, buyers would pay about the same
4 amount per pound of lactose in the two products.
5 Clearly lactose purchased in WPC 34 is far more
6 costly than lactose in dry whey, indicating the
7 products are not being purchased for their
8 lactose content.

9 In addition, recent high prices for lactose
10 reflect a shortage of lactose processing
11 capacity, not a shortage of lactose. If the
12 lactose processing capacity were doubled in a
13 short time frame, the price of lactose would
14 fall precipitously. Lactose processing is very
15 capital intensive, leading processors to be
16 reluctant to add lactose processing capacity
17 unless they believe prices will remain at
18 profitable levels long enough for them to recoup
19 their investment. In fact, much of the current
20 lactose processing capacity was developed simply
21 to reduce the costs of disposing of lactose.
22 The costs incurred in processing lactose were
23 less than the costs of meeting all the
24 environmental regulations to dispose of it
25 otherwise. If the current record high prices

1 for lactose are expected to maintain for an
2 extended period of time, processors will be
3 developing additional lactose processing
4 capacity and prices will, in all likelihood,
5 decline.

6 The value of dry whey serves as the proxy
7 for all whey products. Graph 1 in the protein
8 parity -- in Graph 1, the protein parity value
9 lines for WPC 34 and dry whey show that dry whey
10 served as a very good proxy for WPC 34 until the
11 fall of 2005. Even though dry whey is not as
12 good of a proxy for WPC 34 now as it was, it
13 remains the only proxy available in the current
14 system. Whey products include the milk
15 components of lactose, protein, ash and limited
16 amounts of butterfat. The value of dry whey is
17 assigned to "other solids" in converting whey
18 values to producer milk value. However, when
19 producer milk is tested for other solids, only
20 the components of lactose and ash (including
21 non-protein nitrogen) are measured. Therefore,
22 the major component of value in -- and correct
23 that to saleable, S-A-L-E-A-B-L-E; therefore,
24 the major component of value in saleable whey
25 products, protein, is not being considered in

1 converting whey value to producer prices.

2 Producers can purposely impact the protein
3 production of their cows and herds through
4 culling, feeding and breeding decisions, but
5 they cannot impact lactose production.
6 Approximately one-half of the nation's milking
7 herd participates in Dairy Herd Improvement
8 (DHI) production testing, which includes among
9 its services measuring the protein production
10 for individual cows. Dairy producers can use
11 DHI data to identify low protein-producing cows
12 and if they -- let me start over.

13 Dairy producers can use the DHI data to
14 identify and cull low protein-producing cows if
15 they so desire. DHI testing does not include
16 lactose testing.

17 USDA's Animal Improvement Programs
18 Laboratory (AIPL) calculates predicted
19 transmitting ability (PTA) genetic estimates for
20 cows and bulls. These PTAs include genetic
21 estimates for protein production. Producers can
22 use these PTAs to make genetic selections for
23 protein improvement through their breeding
24 decisions. AIPL does not calculate PTAs for
25 lactose production.

1 Significant research has been done
2 regarding feeding programs that increase protein
3 production. Herd owners can use the results of
4 this research to modify their feeding programs
5 and increase their herds' protein production.
6 Very little, if any, research has been done
7 reading feeding programs that increase lactose
8 production.

9 Producers have many tools at their disposal
10 to affect protein production but virtually no
11 tools to affect lactose production. Updating
12 the price formulas, including the producer pay
13 price, for dry whey to be based on protein
14 instead of other solids will give dairy
15 producers more incentive to improve their
16 production of milk's most valuable component,
17 protein.

18 However, given the recent high prices
19 associated with other solids in producer milk
20 checks, questions are being asked whether the
21 time is right to offer lactose testing as part
22 of the DHI production records program and AIPL
23 genetic evaluations. The fact that other solids
24 are contributing nearly \$2.00 a hundredweight to
25 the Class III price has piqued producer interest

1 in how they can affect their other solids
2 production, which could mainly be accomplished
3 by affecting lactose production.

4 Proposed Price Formula Modification.

5 Assigning the value of dry whey per pound
6 of protein instead of per pound of other solids
7 can be accomplished as follows:

8 $(\text{Dry whey price} - 0.1956) \times 1.03 \text{ yield}$
9 $\text{factor} = \text{Other Solids Price}.$

10 $\text{Other Solids Price} \times 5.69 \text{ pounds of Other}$
11 $\text{Solids per hundredweight in standard milk} =$
12 $\text{Value of Other Solids per hundredweight}.$

13 $\text{Value of Other Solids per hundredweight}$
14 $\text{divided by } 2.99 \text{ pounds of true protein per}$
15 $\text{hundredweight of standard milk} = \text{dry whey value}$
16 $\text{per pound of true protein}.$

17 Combining these three formulas results in
18 the following formula:

19 $(\text{Dry whey price} - 0.1956) \times 1.03 \times 5.69$
20 $\text{divided by } 2.99 = \text{dry whey price per pound of}$
21 $\text{true protein}.$

22 Combined further, the formula becomes:

23 $(\text{Dry whey price} - 0.1956) \times 1.96 = \text{dry whey}$
24 $\text{value per pound of true protein}.$

25 The dry whey value per pound of true

1 protein would be added to the protein price
2 derived from cheese. The revised protein price
3 formula would be as follows (modification in
4 bold):

5 Protein Price = ((Cheese price - 0.1682) x
6 1.383) + (((Cheese price - 0.1682) x 1.572) -
7 butterfat price x 0.9) x 1.17) + ((dry whey
8 price - 0.1956) x 1.96).

9 The Other Solids price would then become
10 zero.

11 Other Solids Price = 0.

12 Currently the other solids price is used in
13 combination with the protein price to determine
14 the Class III skim milk price using the
15 following formula:

16 Class III Skim Milk Price = (Protein
17 price x 3.1) + (Other solids price x 5.9).

18 The revised Class III skim milk price
19 formula would become:

20 Class III Skim Milk Price = Protein price x
21 3.1.

22 Impact of NAJ's Proposal.

23 This proposal was revenue-neutral for
24 Federal Order average component milk from April
25 2003 through September 2006. Table 4 in Exhibit

1 43 compares the whey value per hundredweight of
2 milk using actual monthly other solids and
3 protein test data in combination with NASS dry
4 whey prices. This proposal would have resulted
5 in less -- in a less than 1 cent per
6 hundredweight change, on average, to the Class
7 III price up until September 2006. In the
8 months since this proposal was submitted, the
9 previously mentioned record dry whey prices
10 would have resulted in marginally higher Class
11 III prices.

12 If the answer to the previously posed
13 question regarding the future of whey solids
14 prices is that future prices will be more in
15 line with recent prices, then this proposal lays
16 the groundwork for further modifications and
17 flexibility in milk valuation. If in the future
18 it is determined that whey products other than
19 dry whey should be included in FMMO price
20 formulas, this proposal provides the mechanism
21 through which their protein values can be easily
22 incorporated. Having moved whey's value to be
23 protein based, the next steps could include
24 using WPC 34 prices instead of or in addition to
25 dry whey prices. This could lead to WPC 34

1 prices being included in NASS surveys as well as
2 the inclusion of WPC 34 processing cost data in
3 plant cost surveys.

4 If lactose prices remain at their recent
5 levels, the value of whey solids could be
6 expanded to be based on a combination of whey
7 protein values using WPC 34 and/or dry whey, and
8 non-protein whey solids values using lactose
9 prices and associated processing costs.

10 Conclusion.

11 Federal Order Reform in 2000 was designed
12 to price milk to producers in accordance with
13 the value of dairy products purchased by
14 consumers. Thus, the value of products -- the
15 product values for cheese, butter, nonfat dry
16 milk and dry whey are converted to milk
17 component values for butterfat, protein, other
18 solids and nonfat solids to be used in the
19 classified pricing system to determine minimum
20 regulated prices for producers. In the time
21 since Federal Order Reform was enacted, the
22 market for whey solids has evolved to the point
23 where today their value is due to their protein
24 content and not lactose content. Therefore, if
25 dry whey remains the product of choice to

1 convert whey solids value to producer pay
2 prices, the formula needs to be updated to be
3 protein based instead of being lactose and ash
4 based. If the industry determine that the value
5 of whey solids should be separated into protein
6 and non-protein values, this proposal provides
7 the framework for that development.

8 **JUDGE PALMER:** Do you have anything to add
9 to your written statement?

10 **MR. METZGER:** Unless I miss my mark, I'll
11 be adding things in Cross-Examination.

12 **JUDGE PALMER:** All right. So we should
13 open it then to Cross. Are you ready for it?

14 **MR. METZGER:** Yes.

15 **JUDGE PALMER:** Okay. Who wants to start?
16 Mr. Yale.

17 **CROSS-EXAMINATION,**

18 **QUESTIONS BY MR. BENJAMIN F. YALE:**

19 Q Good afternoon, Erick.

20 A Good afternoon.

21 Q First off, I want to congratulate you on putting
22 together a very provocative, thought provoking,
23 an issue I don't think is talked about enough.

24 I have a couple questions, though, in terms
25 of -- I think the math and stuff I think we can

1 get into, but I want to talk in general about
2 what's in other solids, okay.

3 Now, what we call other solids is
4 everything other than protein and fat; is that
5 right? I mean isn't that what's in the Federal
6 Order right now, or do you know?

7 A Well, when I started looking into this, it
8 seemed like there were two different definitions
9 of other solids.

10 Q That's why I'm asking what you're referring to.

11 A The other solids from the producer milk side,
12 when producer milk is tested for other solids,
13 it's primarily tested for -- well, it is tested
14 for lactose, ash and non-protein nitrogen.

15 However, on the processor side, everything
16 that ends up in the whey stream, including trace
17 amounts of butterfat and a portion --
18 approximately 20 percent of the true protein is
19 lumped into an other solids value, so the
20 current formula, we've got this disconnect
21 between the processor side of other solids and
22 the producer side of other solids.

23 Q So let's call them by specific names. Let's
24 talk about the first one, the ash or the -- you
25 know, the -- that smaller amount. In your

1 research and looking at the Jerseys and the DHI
2 records that track this, is that a fairly steady
3 number that comes out in the milk?

4 A The ash?

5 Q Yes.

6 A Yes.

7 Q And what does that number generally run?

8 A I think it's about .7 percent.

9 Q And it varies more from a regional to
10 regional?

11 A If it varies at all, yes.

12 Q If it varies at all. Okay. Now, let's look at
13 the lactose. What about the amount of lactose?

14 A The lactose in raw producer milk would be
15 somewhere 4.7, 4.8 percent. There's some
16 seasonality variation in there as well.

17 Q All right. I know you promote the Jerseys,
18 okay, so you're always --

19 A We promote equitable milk pricing, and we
20 represent producers of all breeds. Thank you.

21 Q All right. And you do a good job of it. If you
22 look at the issue of lactose, isn't -- lactose
23 is one of those things that's -- in the bovine
24 species is pretty much the same from breed to
25 breed, is it not?

1 A There is -- the variability of lactose is not as
2 great as the other milk components.

3 Q It's more variable than ash?

4 A Yes.

5 Q But it's less variable than the protein or --

6 A And the butterfat.

7 Q Do you have any numbers that talk about the
8 variability of the lactose in the milk?

9 A No, I don't. I actually did rather -- asked a
10 lot of questions of a lot of places, and I was
11 getting heritability estimates on lactose
12 production, but could not get any concrete
13 variability numbers.

14 Q Because you've testified that producers were
15 looking to produce more lactose. I mean is that
16 really a productive and likely effort?

17 A Given the -- given the heritability level of
18 lactose, which runs about .26, or 26 percent,
19 compared to heritability of milk production,
20 which is about .30, it's in the same ballpark.
21 Now, granted, the variability is less. However,
22 if we consider the genetic side of the cattle
23 industry, we have -- and to make genetic
24 progress, it depends on both the heritability of
25 a trait and the variability of that trait within

1 a population. We have genetic evaluations for
2 fertility that are labeled daughter pregnancy
3 rates. The heritability of daughter pregnancy
4 rate is about .03, and yet we calculate genetic
5 estimates for that and incorporate that into
6 breeding programs, so I would not dismiss the
7 potential to develop genetic evaluations for
8 lactose given that the heritability of it is so
9 much greater.

10 It's got its own problems in that I'm --
11 when producers -- you know, for a long time
12 looking at milk checks, so many pounds of fat
13 times fat price, so many pounds of protein times
14 that and so many pounds of other solids times an
15 other solids price, other solids price was
16 pretty low, didn't pay any attention to it. Now
17 that we're pushing up \$2, \$2.50, you know,
18 they're starting to look at that, and it does
19 raise a concern that if we keep going down the
20 path that we're going down now, we're going to
21 take essentially whey protein values, convert
22 them into producer lactose values. Producers
23 will find additional lactose for Mr. Wellington
24 to spread on the fields of New England, and
25 that's -- I mean he testified to that effect in

1 the Strongsville hearing, and that can be a
2 problem for the industry; not just producers or
3 processors, the industry.

4 Q Right. So going back to that, though, you talk
5 about the inheritability, but even through the
6 inheritability, the amount of impact in terms of
7 raising that amount of lactose, the amount of
8 actual lactose that could be increased would be
9 relatively small, would it not?

10 A Compared to the other milk components, yes.

11 Q Okay. So we talk about the ash, that's fairly
12 stable, and we have the lactose, which is
13 relatively stable, not as stable as other
14 things, but in terms of component; the next item
15 that you mentioned in there, in those other
16 solids, was NPN, the non-nitrogen protein;
17 right?

18 A Correct.

19 Q Okay. And what -- how does that normally run in
20 milk? What's the amount of non-protein
21 nitrogen?

22 A Well, I believe when we went from crude protein
23 to true protein, what we were trying to do was
24 subtract out the non-protein nitrogen, and I
25 believe that's a constant of .19.

- 1 Q Okay, .19. So that's -- based on what you
2 understand the testing to be, that's -- those
3 other solids include the NPN, the lactose;
4 right?
- 5 A Yes.
- 6 Q And the ash; right?
- 7 A Yes.
- 8 Q Okay. Now, in that number -- or in that total
9 that you just have there, where do the proteins
10 come from that we're going to pay for? Because
11 they're really -- there's no protein in any of
12 that that's just been mentioned; right?
- 13 A Correct.
- 14 Q Okay.
- 15 A On the producer side.
- 16 Q On the producer side.
- 17 A Correct.
- 18 Q But what happens on the plant side is is that --
19 and we see that in the formulas that we've been
20 talking about, is that you have -- right now
21 there's an implied 82.2 percent of casein that's
22 in true protein; right?
- 23 A Correct.
- 24 Q Okay. And the other side of the whey proteins
25 are the casein proteins; right? I mean there's

1 really those two sets. Isn't that how we divide
2 the proteins in milk between the whey proteins
3 and the casein proteins?

4 A Yes.

5 Q Okay. And the casein proteins are the ones that
6 show up and stay in the cheese; right?

7 A Correct.

8 Q All right. So what's left are the whey proteins
9 that go to the producers; right -- or not go to
10 the producers, the whey proteins that are
11 available to be processed; right?

12 A Yes.

13 Q So, in reality, at the plant level the other
14 solids includes the ash, the non-protein
15 nitrogen, the lactose and the difference between
16 the true protein and the casein that's in the
17 milk; right?

18 A Yes. The casein that's in the -- retained by
19 the cheese.

20 Q Retained by the cheese.

21 A In addition, I mean the cheese yield formula has
22 a constant of minus .1 casein that ends up in
23 the whey stream as well.

24 Q That's right. You're to my next point. So we
25 get that extra factor in there, and then you

1 have to subtract out of that that factor of .09
2 that seems to encompass all the other solids,
3 fat and protein that seems to show up in the
4 cheese in addition; right?

5 A Yes.

6 Q Okay. So going back to from the producers'
7 standpoint and the formulas we have today, we
8 measure the non-protein nitrogen, the lactose
9 and the ash, and that total -- I think if you
10 were to look at the statistics, I think you've
11 done that, but if you look at the Federal Order
12 statistics on other solids, that number rings
13 just pretty steady month in and month out order
14 to order; right? It's a fairly --

15 A Yes.

16 Q So what we have left over that you're wanting to
17 price are the proteins that are the difference
18 between the casein that is kept in the cheese
19 and --

20 A And the true protein.

21 Q -- and the true protein?

22 A Yes.

23 Q Okay. Now, let me -- I want to jump ahead to a
24 little different subject and we're going to
25 circle around, so bear with me, okay.

1 A I'm here all week.

2 Q These are not trick questions, because I think
3 this is something that needs to be understood by
4 all of us, so. And you're the smartest person
5 on this issue, so we need to get this through,
6 okay.

7 A I decline that characterization, thank you very
8 much.

9 Q So if we take -- let's look at this protein
10 issue. I want to back up. We talk about sweet
11 whey. I know you mentioned 13 percent protein
12 in sweet whey, but is there really a standard of
13 identity for sweet whey?

14 A I don't know. I'll be the first to admit that.
15 I know from looking at, I believe it was U.S.
16 Dairy Export Council's Web site where they
17 describe whey, I think it gave sweet whey, they
18 gave kind of a range, and that actual -- quite
19 frankly, the amount of protein in sweet whey can
20 vary depending on the level of protein going --
21 that's in the cheese milk that starts into
22 the -- starts into the vat. That ties into, you
23 know, the statement I made that higher protein
24 milk results in higher protein whey because of
25 essentially the 20 percent of true protein that

1 ends up in the whey stream, so if you start with
2 higher milk, you end up -- start with higher
3 protein milk, you're going to end up with more
4 protein in the whey stream.

5 Q Okay. So isn't -- but WPC 34 does have a
6 standard, at least it says it requires 34
7 percent protein; right?

8 A Correct.

9 Q Okay. So the question comes -- as I understand
10 your proposal, it's basically starting with the
11 dry whey price and backing into the value of the
12 protein; correct?

13 A Right.

14 Q Okay. Why not -- and then dividing that by
15 the -- I think coming up with a factor dealing
16 with the 2.99 -- or 2.9916, which is the amount
17 of true protein in milk.

18 Why not take -- have a determination of
19 what the amount of true other solids are in the
20 milk such as the plants do and subtract out the
21 ash and the lactose and the non-protein
22 nitrogen, which are fairly stable numbers, and
23 that way the variability of the whey protein
24 that individual producers have, and price that
25 off of the WPC 34 protein equivalent, or is that

1 what you're doing anyhow?

2 A I'd have to see your formula to know for sure if
3 I was -- if that's what I'm doing. I don't
4 think that's what's in the proposal. Certainly
5 that would be an alternative approach.

6 Q Because, really, what you're trying to do is to
7 recognize that the value that's driving the dry
8 whey today in large part -- although it's both
9 markets, but in large part is the protein, and
10 that's what the long-term market is for is for
11 the protein in there; right?

12 A That's what we would expect the long-term market
13 to be given the volume of raw lactose that
14 simply isn't being processed at this point. If
15 it were to be processed --

16 Q That market would drop.

17 A Correct.

18 Q Right. Which is one reason those who are
19 looking to process lactose are unwilling to do
20 so because they know that once that volume comes
21 on, they'll be on the other side again; right?

22 A Yes.

23 Q All right. So -- but coming back to this issue,
24 if we measure just the amount of the whey
25 proteins or the non-casein, sometimes you'll see

1 the term non-casein nitrogen or non-casein
2 protein, right, and if we measure that and pay
3 for that, that would result in the same thing
4 that you're seeking to do ultimately, and that
5 is give enhanced -- is to tie the value of the
6 other solids to the value of the protein and
7 nothing else?

8 A I believe that would meet the big picture
9 objective, yes.

10 Q Now, I think in terms of the analysis that
11 you've done and at least I maybe have seen in
12 the past and discussions we've had, I didn't see
13 that so much here, your expectation on the
14 average by the way you've done the formula
15 results in not too much in the way of producer
16 price enhancement?

17 A On average, that's correct, yes. It's more or
18 less revenue neutral.

19 Q All right. But the value up -- goes up and down
20 based upon the amount of protein that the
21 producers produce; right?

22 A To an individual producer, yes.

23 Q Now, does DHIA or the Jersey Association test
24 for all solids -- other solids in the milk in
25 the same way the plants do?

1 A I don't believe that the DHIA system tests for
2 other solids at all. I think the Federal
3 Order -- to the best of my knowledge, the
4 Federal Order System is the only place where
5 other solids per se is tested for.

6 Now, of course, in California where milk is
7 priced on solids not fat, you could arrive at
8 other solids because some producers also, for
9 purpose of inclusion of their records in genetic
10 evaluations, test for fat, solids nonfat and
11 protein, and by doing the subtraction of the
12 protein from the solids nonfat you would have
13 what the Federal Order defines as other solids.

14 Q So to kind of tie things up, if you do a
15 fat/nonfat in terms of the solids in the milk,
16 that's the only -- that's your first true
17 division, the solids not fat include the ash --

18 A Yes.

19 Q -- the lactose, the non-protein nitrogen, the --

20 A And the true protein.

21 Q And the true protein and the whey proteins -- or
22 the true proteins?

23 A Correct.

24 Q And if you divide out the whey proteins, it
25 would be the casein, the whey proteins, the

1 non-nitrogen -- non-protein nitrogen, the
2 lactose and the ash?

3 A I believe that's correct, yes.

4 MR. YALE: Okay. I have no further
5 questions. Thank you.

6 JUDGE PALMER: Any other questions? John.

7 CROSS-EXAMINATION,

8 QUESTIONS BY MR. JOHN H. VETNE:

9 Q Mr. Metzger, good afternoon.

10 A Good afternoon, Mr. Vetne.

11 Q Help me out here. I always thought nitrogen was
12 a gas. Is non-protein nitrogen in milk in a
13 solid form?

14 A I don't know that I can help you with that.

15 Q So to the extent that non-protein nitrogen has
16 been referred to as one of the solids in the
17 category of other solids, you don't know whether
18 it's actually a solid or a gas when thus
19 isolated?

20 A That would be correct.

21 Q Okay. Now, some of the proteins in milk, as you
22 discussed with Mr. Yale, are called casein
23 proteins.

24 A Yes.

25 Q Which is one category of protein produced by a

1 cow. The other proteins, which we call the whey
2 proteins, are, in fact, a number of different
3 protein molecules or protein combinations.

4 Casein is one type, but within the whey proteins
5 there are different subdivisions; correct?

6 A Yes, and there are also different subdivisions
7 within the caseins. Alpha, beta, kappa.

8 Q With respect to the non-casein proteins, those
9 are proteins of a structure and function that
10 are different than casein. They don't -- for
11 example, they don't provide the glue that binds
12 fat and moisture together to make cheese.

13 A That would be correct.

14 Q Okay. And the whey proteins have different
15 functions and different market uses?

16 A That's correct.

17 Q And, in fact, one of the recent market uses for
18 the non-casein protein is in various nutritional
19 supplements.

20 A Yes.

21 Q With respect to the relationship between casein
22 proteins and whey proteins, is that relationship
23 also variable in the producer milk? You talked
24 about the variability of protein as a whole.
25 Now let's look at the subcomponents, the two

1 major categories of protein components, the whey
2 components and the -- the whey protein and the
3 casein protein. Is that variable in
4 relationship?

5 A I would assume that, yes, there is some
6 variation in there. To what degree I don't
7 know. Most things in nature have some
8 variation.

9 Q Okay. But the primary -- the primary protein
10 ingredient which is valued by cheese makers is
11 the casein portion?

12 A In the -- yes, in the cheese side, although you
13 will occasionally hear reports that we're
14 processing cheese in order to get whey; hope to
15 break even on the cheese and profit from the
16 whey.

17 Q That would be a recent development?

18 A Yes, it would be a recent development.

19 Q It has been within our lifetime that whey,
20 including the whey proteins, used to be spread
21 out in the field.

22 A It's been even within my working time that that
23 has happened. And, again, you know, whey should
24 be, and is, one of the real success stories of
25 the dairy industry, taking something that was a

1 useless by-product and creating value from it,
2 and yet we hear repeated statements that whey is
3 causing a problem for cheese, the cheese
4 processors.

5 Q Now, your proposal essentially would take all of
6 the value that is now assigned to what's called
7 other solids and assign that value to protein?

8 A Yes.

9 Q And when that is assigned to protein generally,
10 that value is distributed evenly among the
11 proteins having various functioning, including
12 the casein portion and the whey protein portion?

13 A Yes.

14 Q Under the current system of pricing the value of
15 whey, including the whey protein component,
16 does -- compared to your proposal, does one
17 system or the other tend to reward or fail to
18 reward producers of protein content that varies
19 from the national average?

20 A Well, as I understand the current system, the
21 protein that winds up in the whey stream for all
22 intents and purposes is considered to have
23 evaporated because the whey is valued out to the
24 producer on a essentially lactose and ash basis,
25 whereas the protein that ends up in the whey is

1 not accounted for.

2 Now, if we took -- comparing -- now, to get
3 back to your specific question, higher protein
4 milk will receive more than the average and
5 lower protein milk will receive less than the
6 average.

7 Under my -- under the NAJ proposal, it
8 would shift some dollars from below average
9 protein test milk to above average protein test
10 milk.

11 Q You also talked about non-protein nitrogen and
12 an assumed ratio, I think assumed ratio, of
13 non-protein nitrogen, or assumed content?

14 A Assumed content.

15 Q Assumed content. Based on your study of the
16 issue, have you observed that the non-protein
17 nitrogen content is not variable?

18 A Yes.

19 Q It is not variable?

20 A It is not variable.

21 Q It is not variable. It remains relatively
22 constant regardless of the true protein content
23 of milk?

24 A That's my -- actually, that's my understanding
25 going back to the days when the DHIA system was

1 changing from measuring crude protein to
2 measuring true protein, and to -- even though I
3 wasn't -- I was working at the Jersey
4 organizations but not specifically in NAJ at the
5 time, and the work that NAJ staff at the time
6 was doing to modify the Van Slyke formula to
7 accommodate for measurement of true protein as
8 opposed to the previous crude protein, and
9 everything I remember from that time frame was a
10 constant .19.

11 Q Constant .19 in the test or constant .19
12 employed by those doing the math?

13 A I would -- by those doing the math, which I
14 would assume then would be both.

15 Q You don't know whether they separately tested?

16 A I do not know, correct.

17 Q Now, under your proposal, there would be a
18 change, I think it's on Table 4, in the Class
19 III price; is that right? The table that you
20 referred to, that was almost revenue neutral.

21 A Yes. That would be Table 4, and up through
22 August of '06, the change was, for all intents
23 and purposes, negligible and, of course, the
24 proposal's being due at the end of September,
25 the August component values were the most recent

1 data that were available.

2 In the time since then, the proposal would
3 have -- on average test milk, would have
4 averaged -- or added in the last four months
5 five or six cents to the Class III price, but,
6 again, we're dealing with a market dynamic that
7 we've not seen before.

8 Q All right. One of your objectives here is to
9 transmit price and component value signals to
10 producers; is that correct?

11 A That's correct.

12 Q Now, is it -- isn't it true that that can be
13 done in how the pooled producer values are
14 distributed among producers without affecting
15 the price that handlers are charged? You're
16 proposing to do it both on the handler side and
17 the producer revenue distribution side.

18 A That is correct.

19 Q What you propose, and to meet your primary
20 objective, can be done only on the producer
21 side; correct?

22 A I suppose it could be. I didn't think of that
23 particular approach.

24 MR. VETNE: Okay. Thank you.

25 JUDGE PALMER: Any more questions? Yes,

1 Mr. Rosenbaum.

2 **CROSS-EXAMINATION,**

3 **QUESTIONS BY MR. STEVEN J. ROSENBAUM:**

4 Q Do I -- if I understand correctly, your proposal
5 would shift the whey yield over to the protein
6 component; is that right?

7 A That's correct.

8 Q And you would assume a whey yield of 1.96 pounds
9 per pound of protein, is that what your formula
10 does?

11 A In the narrow sense, yes. However, in the
12 broader sense, what -- what we're trying to
13 accomplish here is to recognize that the
14 majority of whey solids are going into the
15 concentrated forms of whey product, WPCs and
16 WPIS. The yield of those products is dependent
17 on the protein in the milk or in the whey
18 stream.

19 The yield of dry whey is not as -- is
20 marginally dependent on the amount of protein in
21 the whey stream. There is -- but, again, the
22 dry whey is serving as the proxy for the WPCs
23 and the WPIS, which are the majority use of whey
24 proteins.

25 Q Let me take, as an example, milk that has a --

1 that contains 2.9 pounds of protein per
2 hundredweight; okay?

3 A Okay.

4 Q Now, do I understand that under your formula,
5 the assumption would be that there would be
6 5.684 pounds of whey, and I derive that by
7 multiplying the 2.9 pounds of protein by the
8 assumed 1.96 pounds of whey per pound of
9 protein?

10 A I'm sorry, again, please.

11 Q I'm multiplying 2.9 pounds of protein, which is
12 my assumed composition of the milk, and
13 multiplying it times what I understood you to
14 say was the assumed whey yield per pound of
15 protein, namely 1.96 pounds of whey -- of whey
16 per pound of protein. Is that how the formula
17 works?

18 A Well, the formula -- okay, dry whey price minus
19 the make allowance times 1.96 would be the value
20 per pound of true protein.

21 Q My question is if you assume -- given that
22 formula, if you assume that there is 2.9 pounds
23 of protein in the hundred pounds of milk, does
24 the formula for pricing purposes assume that you
25 are going to get 5.684 pounds of whey?

1 And the reason -- and I'm getting to that
2 calculation by multiplying the 2.9 pounds of
3 protein per hundredweight, which I'm asking you
4 to assume is the composition of the milk we're
5 looking at, and multiplying it times what I
6 understand to be the assumed whey yield per
7 pound of protein of 1.96.

8 A Okay, yes, now I'm with you, and then by
9 extension, that is serving as a proxy for yields
10 of protein concentrated forms of whey products
11 which are the majority use of whey solids at
12 this point.

13 Q But am I correct in my math that it's 2.9 pounds
14 of protein per hundredweight times 1.96 pounds
15 of whey per pound of protein, resulting in 5.684
16 pounds of whey product?

17 A That would be correct.

18 Q Now, let's assume that instead the milk has a
19 protein of 3.4 pounds --

20 A Okay.

21 Q -- which would be representative of some -- some
22 of the -- some Jersey cows potentially; correct?

23 A And higher testing herds of any breed.

24 Q Okay. Now, if we assume that there's 3.4 pounds
25 of protein in the hundred pounds of milk and we

1 multiply now that number times the assumed
2 1.96 pounds of whey produced per pounds of
3 protein, the result, by my math, would be 6.664
4 pounds of whey product, just simple math. Do
5 you agree with that calculation?

6 A I would agree with that calculation, and, again,
7 with that serving as a proxy for products that
8 are more protein dependent on their yield than
9 is dry whey.

10 Q Now, the -- the implication of this is that if
11 one has milk at 2.9 pounds of protein, your
12 formula assumes that you get 5.684 pounds of
13 whey product, we went through the math of that a
14 minute ago; if you assume instead the milk has a
15 composition of 3.4 pounds of protein per
16 hundredweight, then you're assuming through the
17 formula 6.664 pounds of whey product. As you
18 can see from the math, your calculation results
19 in approximately one pound extra of whey product
20 as a result of a half a pound more of protein in
21 the milk. And is that a -- do you see -- do you
22 follow my logic at least? You can tell me I'm
23 wrong, but do you see my logic?

24 A I understand your logic, and now what I'm trying
25 to do is to take that a step further, the

1 concept being that yours -- that calculation is
2 on dry whey, and one of the attempts of this
3 proposal was to recognize that the majority of
4 whey solids, particularly whey proteins, are
5 going into protein concentrated forms of whey
6 products, the WPCs, the WPIS, and obviously
7 the -- the yield of those products which serve
8 as the majority product for the whey stream are
9 more dependent -- are almost entirely dependent
10 on the protein in the whey stream, whereas dry
11 whey is not, so we've got dry whey, which is --
12 we've got an established process to collect
13 prices on that serving as a proxy for all whey
14 products.

15 Well, here recently the majority of the
16 whey stream is going into the more concentrated
17 form of whey product and not just dry whey.

18 Q If one were looking at dry whey itself, you
19 certainly would not anticipate --

20 A Dry whey itself?

21 Q You wouldn't anticipate an extra pound of
22 product resulting from an extra half pound of
23 protein; correct?

24 A That is correct. That's why it's important that
25 it serve as a proxy for the others.

1 Q And, in fact, the other major nonfat solid
2 component of milk, of course, is lactose;
3 correct?

4 A Yes.

5 Q And you would not -- and unlike protein, lactose
6 is, relatively speaking, a flat component of
7 milk; is that right?

8 A Flatter.

9 Q Flatter. And so you certainly would not expect
10 a simultaneous increase in the amount of lactose
11 going from 2.9 pound protein to 3.4 pound
12 protein, you wouldn't expect the lactose
13 simultaneously to experience that kind of change
14 in milk; correct?

15 A That would be correct.

16 MR. ROSENBAUM: That's all I've got.

17 JUDGE PALMER: Other questions?

18 Mr. Beshore.

19 **CROSS-EXAMINATION,**

20 **QUESTIONS BY MR. MARVIN BESHORE:**

21 Q Mr. Metzger, we heard testimony today from
22 several cheese manufacturers with respect to
23 their concerns with the current pricing of other
24 solids.

25 A Yes, sir.

1 Q Would your proposal address that in any way?

2 A It would -- yes, the answer to that is both yes
3 and no, okay.

4 The yes part is from the standpoint that it
5 recognizes that significant valuation of whey
6 products is due to protein content, whereas the
7 no part is -- and this, again, is the
8 development that's happened in the market since
9 proposals had to be submitted last September,
10 doesn't recognize what's happened in the lactose
11 market in that period of time. And I believe as
12 I stated in the testimony, I think this proposal
13 gives us a good first step towards a more
14 comprehensive approach to valuing whey product,
15 should we recognize over time that lactose
16 prices are going to stay at or near current
17 levels.

18 As I view the situation with -- you know,
19 the current whey valuation situation is if we --
20 if we go to, I believe it's Graph 1 of Exhibit
21 43 where we look at the value of a pound of
22 protein in dry whey compared to the value of a
23 pound of protein in WPC 34, from -- they tracked
24 each other very closely for quite a period of
25 time. Sometimes one was higher, sometimes the

1 other was higher. As we got into about the '04,
2 '05 time period, the value of a pound of protein
3 in WPC 34 exceeded the value of a pound of
4 protein in dry whey, so obviously if you're a
5 cheese manufacturer and you're thinking what am
6 I going to do with my whey stream and I've
7 either got to, you know, develop something or
8 revamp something, if I can buy whey proteins at
9 the dry whey price, which is here, sell it at
10 the WPC 34 protein price, which is above here,
11 I'll realize additional returns, and so the
12 logical business decision was made by many
13 cheese plants to put in WPC 34 processing
14 capacity. Well, supply and demand took over and
15 what happened was, you know, dry whey production
16 has stayed virtually flat, which I believe was
17 demonstrated in Table -- I believe it's Table 3,
18 whereas the amount of proteins going into the
19 more concentrated forms of WPC and WPI went up,
20 so we had more of that on the market, dry whey
21 was staging flat, and so then that price -- that
22 price changed. And what's happening now is
23 we've got cheese processors that are selling
24 whey proteins at the WPC 34 price, which is less
25 than the whey protein price in dry whey, and

1 that's causing a significant amount of the
2 strain right now, in my opinion.

3 Q Right. That's what we heard about. But your
4 proposal would still price all the protein off
5 the dry whey market, so it wouldn't really
6 address that issue at all; right?

7 A It would start to address that issue, because I
8 think it -- like I said, it lays the framework
9 for us to go forward, and inertia is a very
10 powerful force, and I think the proposal gets us
11 off of this inertia of, rather interestingly,
12 you know, the cheese processors who are having a
13 problem with other solids valuation or whey
14 valuations, we've not yet seen a proposal, other
15 than perhaps make allowance changes, to address
16 that.

17 This proposal would get us moving in a
18 direction to more comprehensively address what's
19 happening in the whey solids market.

20 Q Let me ask you one other question. Have you
21 calculated the impact of your proposal on the
22 average Jersey producer versus the average
23 Holstein producer?

24 A No, because that's not really what we're looking
25 at. It's -- it's not a breed-based proposal.

1 It's an economics-based proposal.

2 Q Well, let me take the breed base out of it and
3 just say, you know, the average -- say the top
4 10 percent of producers in the Federal Order
5 System in terms of protein percentage in their
6 milk versus the lowest 10 percent in terms of
7 percentage of protein in their milk, have you
8 calculated what the impact of your proposal
9 would be with those -- with those sets of
10 producers?

11 A With those sets, there would be a transfer from
12 the lower protein producers to the higher
13 protein producers.

14 Q I gathered that from your testimony, but I'm
15 looking at whether there are any numbers.

16 A I don't know where I would cap the top 10
17 percent and what I would -- you know, what would
18 be the floor on the top 10 percent and the
19 ceiling on the bottom 10 percent.

20 Q You've done a lot of calculations here, you've
21 got done a lot of chart work and very sharp
22 pencil work.

23 Have you made any -- can you provide any
24 information for the record in terms of what that
25 transfer of income among producer groups might

1 be under your proposal?

2 A Marvin, it depends on what the whey price is.
3 It also -- there is variation in other solids
4 tests among producers. We see that even amongst
5 our Jersey board.

6 Q I'm not telling you what assumptions to make.
7 I'm saying have you made any assumptions, run
8 any numbers that you can provide for the record
9 in terms of evaluating the impact of your
10 proposal?

11 A In all honesty, Marvin, we have looked at it
12 from a perspective of a -- one of the things
13 that we provide for our National All-Jersey
14 board members, and they meet three times a year,
15 is a milk -- milk check comparison, because
16 they're from all across the country and
17 different revenues, different costs, different
18 co-op costs, different hauling costs, etc., so
19 there's kind of a competition, if you will,
20 among board members, and also to show the impact
21 of different -- we still have NAJ board members
22 in fat skim orders.

23 We have on two occasions run the analysis
24 of this proposal on the board members that are
25 getting -- or receiving an other solids price

1 through their milk check. I am -- when I say
2 we, I say that liberally because Sara actually
3 runs them. And I honestly don't recall what
4 those differences were.

5 I think -- if I remember one time, I think
6 it was last November, for our November meeting,
7 we were working off of September pay prices, and
8 I think at that point the difference for those
9 producers gaining on protein, losing on other
10 solids was a dime or twelve cents a
11 hundredweight.

12 MR. BESHORE: Okay. Thank you.

13 JUDGE PALMER: Other questions? Mr. Yale.

14 **CROSS-EXAMINATION,**

15 **QUESTIONS BY MR. BENJAMIN F. YALE:**

16 Q You saw the testimony that I had yesterday where
17 I did the charts that looked at, first of all,
18 the percent of casein that was in true protein;
19 do you recall that?

20 A Yes.

21 Q And the point was was that the level was set at
22 a different level of protein than what was the
23 average being delivered to plants.

24 A I recall that, and in looking at your level, I
25 know from work done by -- again, work done by

1 NAJ staff prior to me joining that staff, when
2 we were going from the crude protein to the true
3 protein measurement, I believe we used -- or
4 recommended using in the Van Slyke formula a
5 .829. I believe your formula was --

6 Q Yeah, .822 now, we were proposing .825 but
7 you're proposing .829.

8 A .829, I believe that's what we've got out on our
9 Web site.

10 Q Right. And that was based upon an average test
11 of producer milk and the casein in producer
12 milk; is that where the basis of that was?

13 A I believe so.

14 Q Okay.

15 A There may be a witness later in the testimony
16 hearing that I may ask a few questions of.

17 Q My point is -- we will not identify him or her.
18 We want to make sure that they appear on the
19 stand.

20 A Yes, so they don't run screaming into the night.

21 Q But that's on test. I mean your proposal is to
22 divide by the .29915 or 2.99?

23 A 2.99.

24 Q That's the standard.

25 A Yes.

1 Q Do you have a problem if that was divided by the
2 average of the amount of protein at test in the
3 producer milk?

4 A No. In that formula we used the standard for
5 both the other solids and for true protein. If
6 we -- if it were to be done by the average,
7 certainly that would be acceptable.

8 MR. YALE: All right. Thank you.

9 JUDGE PALMER: Any other questions? That
10 table over there?

11 Did you wish to add anything to your
12 statement?

13 MR. METZGER: No, thank you.

14 JUDGE PALMER: Correct anything that you
15 think might have got confused?

16 MR. METZGER: That's what I have Sara back
17 there for. She was supposed to do Redirect if I
18 misstated anything too much.

19 JUDGE PALMER: She thinks you did a good
20 job. Thank you very much.

21 MR. METZGER: Thank you.

22 JUDGE PALMER: Let's go off the record for
23 a second.

24 *(A discussion was held off the record.)*

25 JUDGE PALMER: On the record. We're

1 receiving Exhibits 42 and 43. Thank you.

2 *(Thereupon, Exhibit Nos. 42 and 43 were*
3 *received into evidence.)*

4 **JUDGE PALMER:** Let's take a little recess.

5 *(At this time a recess was taken.)*

6 **DR. ROGER CRYAN,**

7 having been first duly sworn in by the Judge,
8 was examined and testified under oath as
9 follows:

10 *(Thereupon, Exhibit No. 44 was marked for*
11 *purposes of identification.)*

12 **JUDGE PALMER:** We're marking the doctor's
13 statement as Exhibit 44, and he's been sworn,
14 and Mr. Beshore will now examine.

15 Go ahead, sir.

16 **MR. BESHORE:** Proposed Exhibit 44 is not a
17 statement. Dr. Cryan has a document which he
18 would like to offer for the record in
19 supplementation to his testimony at the -- in
20 Strongsville in February, and this is a piece of
21 information that has come into his possession
22 since that time.

23 **DIRECT EXAMINATION,**

24 **QUESTIONS BY MR. MARVIN BESHORE:**

25 Q And with that, Dr. Cryan, could you tell us what

1 Exhibit 44 is.

2 A Yes, sir. Let me just preface -- let me repeat
3 what Marvin said. This is not a written
4 statement. I do not have a written statement.

5 My name is Roger Cryan, C-R-Y-A-N, and I
6 represent the National Milk Producers Federation
7 which put forward Proposal No. 17 in the
8 original notice of hearing. I testified in
9 Strongsville in favor of energy cost indexing to
10 make allowances.

11 At that hearing there was data presented on
12 costs of processing and discussions of updated
13 cost -- processing cost data from the California
14 Department of Food & Agriculture.

15 In order to complete my testimony, I needed
16 data from the department -- California
17 Department of Food & Agriculture regarding
18 electricity and gas costs that are an element of
19 the overall costs of processing that were
20 presented at that hearing and presented more --
21 or published more extensively following that
22 hearing.

23 I made a request -- this particular -- this
24 document -- and by the way, there are copies on
25 the back table. This particular document

1 contains -- it has two parts. The first part --
2 let me start with the back part. The back part
3 is a series of -- string of e-mails starting
4 with my e-mail to Venetta Reed, who is the
5 supervisory auditor at the California Department
6 of Food & Agriculture in their dairy offices who
7 was responsible for overseeing the manufacturing
8 cost of processing studies that the state of
9 California does for the dairy industry.

10 I sent her an e-mail requesting the same --
11 requesting this detail on electricity and gas
12 costs for these processors. She had provided
13 the same sort of data, or at least confirmed the
14 same sort of data in a previous proceeding. And
15 I asked her to provide the same sort of data.

16 I believe that what she provided is
17 self-explanatory, but let me go over this
18 briefly. There is -- there's a published study
19 by the Department of Food & Agriculture on
20 Manufacturing Costs, Annual, 2006, which
21 contains data for 2005. That's the latest data
22 published by the Department of -- the California
23 Department of Food & Agriculture on
24 manufacturing costs.

25 I asked her to provide the utility costs,

1 specifically the electricity and gas costs that
2 are relevant elements of those costs in order to
3 update our proposal for energy cost indexing of
4 manufacturing cost allowances in the Federal
5 Order, Class III and Class IV price formulas.

6 The e-mail also contains her response
7 confirming that this is what I -- this is what I
8 asked for, and the letter contains all the data,
9 all the data that I requested.

10 And that's all I have to say about it right
11 now.

12 **JUDGE PALMER:** Do you have any questions?
13 Pretty self-explanatory, but we may have some
14 questions. Do we? Mr. Beshore.

15 **QUESTIONS BY MR. BESHORE:**

16 Q Did your prior testimony, Dr. Cryan, explain I
17 think how these data would be utilized in the
18 formula on Proposal 17?

19 A Yes, Mr. Beshore, I believe that they did. I
20 believe my statement in February went through a
21 methodology to which these numbers could be
22 readily applied --

23 Q And are the --

24 A -- if the Department chooses to apply the
25 updated California manufacturing cost numbers.

1 Q Are the figures cost per pound of product?

2 A Yes. Yes, they are. Yes, they are. Thank you
3 for the clarification. I appreciate that. That
4 is not in the text. For clarification, I would
5 repeat that, that these numbers are all cost per
6 pound.

7 **JUDGE PALMER:** Anything else? Doesn't
8 appear to be anything else, so thank you very
9 much.

10 We'll receive the document. So Exhibit 44
11 is received.

12 *(Thereupon, Exhibit No. 44 was received*
13 *into evidence.)*

14 **JUDGE PALMER:** And I guess we now close
15 down until tomorrow morning at nine o'clock.

16 *(At 5:43 p.m., Tuesday, April 10, 2007, the*
17 *hearing in this matter was recessed, to*
18 *reconvene at 9:00 a.m., Wednesday, April 11,*
19 *2007.)*

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1 STATE OF INDIANA)
2 COUNTY OF MARION) SS:

3

4 I, Dianne D. Lockhart, a Notary Public and
5 Stenographic Reporter within and for the County of
6 Marion, State of Indiana at large, do hereby
7 certify that on the 10th day of April, 2007, I took
8 down in stenograph notes the foregoing hearing;

9 That the transcript is a full, true and
10 correct transcript made from my stenograph notes.

11 IN WITNESS WHEREOF, I have hereunto set my
12 hand and affixed my notarial seal this 17th
13 day of April, 2007.

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Dianne Lockhart
NOTARY PUBLIC

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20 My Commission Expires:
21 July 22, 2007

22

23 County of Residence:
24 Marion County

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