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BEFORE THE SECRETARY OF

THE UNITED STATES DEPARTMENT OF AGRICULTURE

AGRICULTURAL MARKETING SERVICES

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

National Public Hearing

Thursday, April 12, 2007

9:15 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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JUDGE PALMER: On the record. Is everybody ready to get started. Mr. Beshore.

Mr. Gallagher is on the stand and still under oath.

EDWARD W. GALLAGHER,

having been previously sworn, was examined and testified as follows:

DIRECT EXAMINATION (CONTINUED),

QUESTIONS BY MR. MARVIN BESHORE:

Q Thank you, Your Honor. Mr. Gallagher, do you have a document the first page of which is headed "Additional Information of Dairylea Cooperative, Inc."?

A Yes, I do.

MR. BESHORE: Has this been marked for identification as Exhibit 54, Your Honor?

JUDGE PALMER: No, it has not. Let's do that right now.

(Exhibit 54 was marked for identification.)

MR. BESHORE: I would like to request that, please.

JUDGE PALMER: This will be 54.

Q Mr. Gallagher, could you tell us what Exhibit 54 is?

A Yes, after the listening session for this proceeding that happened in December, USDA had requested that by or before December 19th or so, the industry submit requests for information and data to support their proposal; and so attached is the letter that I had sent, which is on the USDA website, and then -- so that's the first two pages. And then the page that begins with a map and it's a few pages long and ends with a map is the data that I got back from USDA per that information request. That information got to me on April 3rd after I had pre-submitted my testimony, so I didn't get a chance to address this in my testimony.

The tables that are -- all the tables that make up the remainder of the exhibit are -- is information -- some of it is information that I requested from USDA that they didn't include in their information submission, but I went and put the information together on my own and created the tables on my own.

Q The tables are the last four pages; is that correct?

A That's correct.

Q Last four sides of Exhibit 54?

A Yep.
Q Could you just describe those briefly?
A Okay. The first table that says "NASS Price Survey Dairy Product Pounds Compared to Total U.S." are for the four products that are in the NASS price survey, and it shows the first column "NASS Survey" are the pounds of product each year that were included in the NASS survey. And the second column is for those same products, the products USDA reported as were produced in total in the United States. And the third column, then, is the percentage that the NASS pounds are of the total produced in the United States for those particular products.

The second graph, then, is -- or excuse me, the second table the next page that shows cheddar cheese, it's the same pounds for cheddar cheese in the NASS survey as on the first table, but then I compared that to total cheese production in the United States as opposed to just cheddar cheese production. So the NASS is a percentage of total cheese production.

The third table is an attempt to -- well, the first three columns, which says "Butterfat, Skim" and "Total Solids" are my attempt to

calculate the milk equivalent in the pounds of product included in the NASS survey. And I computed it three ways, butterfat equivalent, skim equivalent and total solids equivalent. And to make the calculations, I used, for butterfat and skim, the factors that are reported in Dairy Market News, and for total solids I took 50 percent of the butterfat plus 50 percent of the skim and added them together to get total solids.

The next two columns are "Federal Order and California." And the first column -- fourth column is Class III and IV receipts, so it would be for each of those years total annual Class III and IV pounds under Federal Orders as reported by USDA, plus their equivalent under the California state order. And then the producer receipts would be Federal Order producer receipts plus California milk production. And then the final column is "U.S Milk Production" total for the year.

The final table, then, is a calculation that I made based on the prior table, and it's "Percentage of U.S. Milk Production With" -- what I'm calling -- "a Circularity Issue, Based

on Selected Comparable Category."

The calculation looks at the total solids milk equivalent that I calculated of pounds of product in the pricing survey, that would be the numerator, and the denominator would either be the Class III and IV receipts or the producer receipts of the U.S. milk production. So this is then saying, to give you an example, in 2006, 20 percent of the milk produced under Federal Orders in California, and that was utilized in Class III or IV, was made into a product that is included in the dairy product survey.

Q The NASS survey?

A NASS survey.

So that would say 80 percent of the Class III or IV milk doesn't have a circularity issue, 20 percent has a circularity issue. If you look at it all the way over to "U.S. Milk Production," 10 percent of the milk produced in the United States is in the NASS survey and has a circularity issue, 90 percent produced in the United States does not have a circularity issue resulting from the NASS survey Federal Order pricing.

Q One final question, then, on direct,

Mr. Gallagher. For clarification, in Mr. Beeman's testimony there was reference to two membership numbers for -- or two farm numbers for Dairylea, 2,400 and then he mentioned a 1,400 number.

Can you clarify those numbers?

A Sure. Dairylea has a number of member cooperatives; cooperatives who have joined Dairylea as members. Bill referenced the number of direct Dairylea members, and the other thousand are members of cooperatives who have joined Dairylea as member cooperatives.

Q And the member cooperatives market all their milk through Dairylea?

A Yes.

Q Thank you, I have -- I'm sorry?

A I didn't get the opportunity to include this information in my testimony from yesterday. There are a couple of points I would like to make, I would like to glean from this data.

Q Please do.

A If I could. Thank you.

First of all, one of the primary reasons I asked for the data was I know at the listening session there were concerns about what may be

the immensity of this auditing process to have an audit trail here to see if -- you'll see what's being reported. A couple things I would like to comment on.

One, I know that there's a rule out there that hasn't been published and hasn't been made public, but through different ways I can, you know, we all have ways of finding out information about what's going on. One of the things I do know that has been proposed is that there's going to be some sort of auditing process for this NASS pricing survey.

So there is some process within the department already to think about how we audit this stuff.

Q That would be to implement what is in the --

A It's already being done.

Q And the parts of the law which were put into the statute that were put into the record yesterday that says that reporting can be verified?

A Correct. And so then I was curious, well, what is the enormity of this auditing process. And from the data here it says that there are 87 plants that are providing data that goes into the NASS survey.

Okay, well, I used to work for the Federal Order in the Northeast Order, I'm pretty close to the Northeast Order. On a regular basis they audit more than 87 plants just in that order. So they've got a system already. There's a system set up that easily audits more than 87 plants.

Secondly, what I was trying to get at is the concentration, you know, the old 80/20 rule; 20 percent of the entities produced 80 percent of the product. We see that across all forms of agriculture. And I've got to believe some of that is very similar in the production of dairy products, and so I was trying to get at how many are there of these really large entities that are the most important audit. Unfortunately, I wasn't able to get that information on a dairy division, but I would submit that you know the enormity of this really isn't 87.

Also, they have something called reporting entities to report the data, and to give you an example, Dairy America reports the data for their members. So in powder, you really have one entity that you have to make sure reports correctly. So I don't think that's that

difficult of a process to make sure one entity reports correctly.

Also, I believe DFA is a reporting entity. I believe they report for all their plants. I certainly would submit that I think with the right outreach program from USDA to the industry, that I think the process of implementing the Dairylea proposal could run pretty smoothly with some advanced notice and outreach from the industry to work with them, especially in this day and age of electronic submission of information and the technology that's available, I think it could run pretty smoothly.

The other thing I would submit is that if you took the plants that report this data that are outside of California, I don't know the data in this, I didn't ask the question, but I would say that probably at least 75 percent of the product is produced in plants where regularly Federal Order auditors show up. And so the process of auditing this I don't think is going to be very difficult. I think it's just going to be, you know, a fairly easy process to do.

I think that's about all I'd say.

Q Okay. And those comments are relating to verifying the invoicing of products as proposed in proposal 20?
A Correct.
Q Okay. Thank you.
JUDGE PALMER: Questions? Yes, Mr. Rosenbaum.

CROSS-EXAMINATION,

QUESTIONS BY MR. STEVEN J. ROSENBAUM:

Q Good morning, Mr. Gallagher. Steve Rosenbaum representing the International Dairy Foods Association.
A Good morning.
Q Mr. Gallagher, what products, what manufactured products does Dairylea currently manufacture and market?
A We don't manufacture any products. We don't operate any plants.
Q Historically, did Dairylea have interest in manufacturing plants?
A Yes.
Q Has Dairylea divested itself of those interests over time?
A Yes. I don't even believe we're invested in any plants at this point in time.

Q Okay. I want to concentrate on your proposal 20 and how it would work. And I want to take us through a simple hypothetical.

A Sure.

Q I thought because it's going to involve a few numbers, it would be easiest for me to write up on the screen for us to look at. They're not going to be complicated.

I'd like to have you assume a situation. Let's assume the price of cheese on the CME and NASS is $1.40 a pounds, okay? And let's assume that the make allowance is $0.17, which is pretty close to its current level. Now, without getting into the intricacies of component pricing under that circumstance, the minimum price that the Class III handlers have to pay to its farmers is $1.23, correct? Obviously you convert that.

A Right, but the cheese price goes back into the calculation.

Q Is the minimum milk price.

Now, let's assume that the actual cost of manufacturing is $0.20, meaning that the costs are up $0.3 over the make allowance. And I think that's going to be all the information we

need for my questions.

Now, I want you to assume -- so let's assume that industry is in complete agreement, which it's not always, but let's assume industry is in agreement as to what the cost of manufacturing are; that is to say $0.20 is correct.

A Okay.

Q So we're not going to get in debate over that. We've all agreed it's $0.20.

Now, up until today, excluding this proposal, so to speak, the reaction based upon how USDA has addressed the situation between January 1, 2000 and today is that under that scenario, USDA would increase the make allowance by $0.3 to $0.20, correct?

A Sure; that's part of what our issue is, yes.

Q And the result would be that a manufacturer whose costs are equal to these average costs of $0.20 would be able to pay its farmer the minimum milk price and it would have $0.20 left over, and that would be enough to cover its cost of manufacturing; is that correct?

A Correct.

Q Now, let's assume that your proposal is adopted;

that's what I want to contrast it with.

A Okay.

Q Now --

JUDGE PALMER: There's a religious group in the other room. I think we're getting a little bit of their music.

Q But let's assume the Dairylea proposal is adopted, and so we're at a scenario where the make allowance is $0.17, but the Dairylea proposal is in place.

We've gone through, essentially, the same hearing process and determined that the true cost of manufacture is $0.20, correct?

A The proposal allows it to happen either way. USDA just routinely does it or you have a hearing, either way.

Q For purposes of my hypothetical, it doesn't matter whether through a hearing or through some other mechanism; but one way or the other USDA has recognized, determined that the actual cost of manufacturing is $0.20 rather than $0.17, okay?

A Yes.

Q Now, under your scenario, what happens is that the make allowance doesn't change at all,

correct?
A Correct.
Q And so the minimum milk price stays at $1.23, correct?
A Yes.
Q And so if the price of cheese remains at $1.40, the make allowance is at $0.17 still, the minimum milk price is $1.23, the manufacturer is losing $0.3 for every pound of cheese it makes, correct?
A Not necessarily because they pass the cost down.
Q Down to?
A They can pass the cost on.
Q That's the question.
A Okay.
Q If the price of cheese remains at $1.40, then the manufacturer is losing $0.3?
A No, that's not true. Cheese is regularly sold at CME plus something; and that doesn't get reflected in the CME price, unless it's in the NASS survey, doesn't get reflected in the NASS survey. And my data shows that most of the cheese produced in the United States is not in the NASS survey.
Q Let me put it differently. Unless the

manufacturer is able to pass on these extra costs in the form of higher cheese prices, it's losing $0.3 a hundredweight, correct?

A Under that scenario it would be no different than a dairy farmer who is unable to pass on their higher costs, they'd be losing.

Dairy farmers, as they are now, are losing money.

Q So what USDA will do, under your proposal, when the cost of manufacture has been determined to be $0.3 higher than the make allowance, USDA will not change the make allowance at all, correct?

A Correct.

Q USDA will instead put out a piece of paper that says to the world "cost of manufacture up $0.3," correct?

A Yes.

Q That piece of paper that USDA puts out will, itself, have no legal effect, correct?

A Correct.

Q It will not legally mandate -- it will not -- the existence of that piece of paper will not permit a cheese manufacturer to reduce its minimum milk price, correct?

A Correct.
Q That remains unchanged at $1.23 under this scenario, correct?
A Correct.
Q That piece of paper does not legally entitle a cheese manufacturer to obtain any higher cheese price than it was already able to obtain in the marketplace, correct?
A Correct.
Q And now if your system -- and so if under proposal 20, manufacturers are unable to pass on any higher cheese prices, they're really sunk?
A They're in the same position as the rest of the manufacturing world.
Q Well, no, because they have a minimum milk price; that's not true at all.
A Sure it is; they can negotiate with their customer to change the price.
Q Well, that's what I said was, unless the manufacturer is able somehow to extract a higher cheese price, it's sunk and it's not like any other manufacturer because it has a legal requirement to pay the $1.23?
A No, that's not true; they can negotiate with their supplier to share in the cost increase by

lowering the over-order premium.

There's a number of avenues here.

Q Is it your supposition here that there's enough over-order premiums to absorb the entirety of any cost of manufacturing increase?

A Yes.

Q Is that the effect you perceive to come out of this?

A No, because we won't give it all up.

Q Now, let's go to the scenario of this cheese processor.

JUDGE PALMER: Let me ask one question. I hope I don't throw everything off by asking it.

But the piece of paper, as Mr. Rosenbaum put it, that says we really should be $0.3 higher, would there be any likelihood that contracts could reference that happening and saying whatever price we set, either the price we sell our cheese to somebody for or the price that we have paid for the milk to make this cheese, will be in some way affected by that?

A Absolutely, and it happens already, Your Honor. In the Class I price announcement, they have a $0.20 promotion fee that they include in the Class I price announcement.

There is no legal requirement that a Class I -- a supermarket, or whatever is purchasing the milk from the Class I processor, has to pay that; but they have agreed to pay that because it's showing up on a form produced by the federal government that includes it and the Class I processors are able to pass that cost along on their sales that otherwise would be entirely borne by them.

JUDGE PALMER: I take it that you prefer that the cost be passed on to the buyer from the cheese maker rather than being passed back to the supplier by reduction in premiums?

A Absolutely.

JUDGE PALMER: All right. I just thought I would put where they are.

All right, Mr. Rosenbaum.

Q We'll get to the $0.20 in a minute, but let's keep on this narrow hypothetical.

A Sure.

Q Now, your scenario is one in which a manufacturer could try to provide an invoice to his customer that says I'm now charging you $1.43 for cheese, the $1.40 plus a $0.3 surcharge based upon the USDA piece of paper,

correct?

A Correct.

Q And if successful in doing so, you would have the NASS survey ignore the $0.3 in determining what the price is, correct?

A Correct. As long as the $0.3 isn't more than the regulated amount.

Q And under that scenario, you would say that the manufacturer is getting $0.17 for the make allowance and $0.3 through exclusion from the NASS survey for a total of $0.20 to cover its cost of manufacture; that's your concept, correct?

A Getting $0.17 from the make allowance and $0.3 from the market.

Q And the way you get $0.3 from the market is to exclude it from the NASS survey; and, therefore, it doesn't increase the minimum milk price, correct.

Is that the concept?

A In your simple example, yes, but it goes beyond the NASS survey because it's going to be an opportunity for Sarento Cheese to utilize when they sell to their customers on their mozzarella that's not in any type of survey, to pass that

cost along, too.

Q Well, let's focus on cheddar cheese, because it's the price-setting mechanism.

The way it works for a cheddar cheese manufacturer in your "hopeful world" is that you get the extra $0.3 by increasing your price by $0.3, labeling it a surcharge, and it's, therefore, excluded from the NASS survey?

A Correct.

Q That's the mechanism?

A For instance, when Dairy America had their surcharge, and I had an example in here it was $0.23 a pound. They could have kept that and it wouldn't have been included in the NASS survey and it would have covered some of their energy costs, so, yes.

Q Now, let's assume -- I assume a customer is going to say why the heck are you now for the first time ever, Mr. Cheese Manufacturer, instead of listing on invoice a price per pound, listing a surcharge?

I mean, certainly customers are going to ask why, don't you think?

A Absolutely they will.

Q And presumably, a cheese manufacturer would then

have to say, well, here's how it works, and here's why it makes sense to break out the $0.3 separately. Right, I mean those conversations would take place, right?

A And in this environment, this day and age talking about some sort of surcharge I think is a pretty normal business conversation because I've got to believe anybody that is buying anything has had some -- whether it's their own personal purchases in their home or for their business -- has had some type of surcharge added to an invoice. And so I don't think it's that big of a stretch to talk to somebody about getting a surcharge on an invoice.

Q But presumably you're going to explain the reason why it makes sense here is because of this regulatory mechanism that makes the surcharge meaningful, right?

A Correct. The USDA has determined that the cost of producing, in this case, cheddar cheese, has increased $0.3 per pound and so the pricing doesn't reflect it and so we need to pass that on to you folks, and here's USDA saying that's the value that should be passed on.

Q And the buyer will be told and the benefit to me

of putting on the invoice $1.40 plus $0.3 surcharge rather than the invoice simply saying $1.43, the advantage is that under the new regulation the extra $0.3 isn't picked up; and, therefore, doesn't raise minimum milk price obligation, right?

A However they want to explain it. That's a way of explaining it.

Q I mean, there are sophisticated buyers out there of cheddar cheese who will either already know that because they know the Federal Order system to begin with, or will demand an explanation and provide that explanation?

A Correct.

Q This is not going to be a secret, right?

A No; you don't want it to be a secret.

Q So why don't I, as a buyer, say, look, the price of cheese has been $1.40. I understand now, under the regulatory mechanism, that if you can report a separate $0.3 surcharge, you get a benefit because that doesn't get picked up by the NASS survey. That's fine.

What the invoice is now going to say, Mr. Cheese Manufacturer/Supplier is the price of cheese is $1.37 and there's a $0.3 surcharge.

And you're made whole as a manufacturer because you get the $0.17 make allowance, but the price of cheese in the survey will now be $1.37, so you get the extra $0.3.

Why won't any buyer who knows anything about the system do that very thing?

A They could. Here is -- and that could happen. I mean, there's no way to prevent that from happening. In the end, what will happen is there's going to be long markets and there's going to be short markets. And in a short market, if a cheese maker has any marketing gumption to them, whatsoever, they're going to easily be able to pass it on. In a long market, they may not; but the net amount is farmers overall will be better off with this system than having constant make allowance changes because they will not always have to bear the full brunt of a make allowance change because from time to time we're going to be able to pass the costs on.

Q But you are saying it would be perfectly legitimate under your system for a buyer to say -- for all buyers to say, if they figure out the system, the price is still $1.40, but it's

now going to be broken down $1.37 for the alleged cost of cheese plus $0.3 for a surcharge; that would be perfectly permissible?

A I don't know how to stop that from happening. I don't say it's perfectly legitimate. I don't know how to stop that from happening and it could happen from time to time.

Q Let's talk about the real world in terms of cheese that's made in the Federal Order system and cheese that's not made in the Federal Order system, okay.

You have provided some information that takes us part of the way there in Exhibit 54 that shows that there are 33 plants in the west that are part of the NASS survey, correct?

A Sure.

Q Now, let me give you some figures, these are from -- is it dairy -- the cheddar cheese production by state, that's NASS?

Let me give you the NASS figures for two states, California and Idaho. I believe these are already in the record.

But in 2004, California had a 17.9 percent share of total cheddar cheese production. Idaho had 16.2 for a total of those two states,

34.1 percent of all cheddar cheese production.

2005, California dropped to 17.1 percent, Idaho went up to 16.8 percent, total combined of 33.9 percent of all cheddar cheese production is in California and Idaho alone, okay?

A Okay.

Q Now, obviously, California is outside the Federal Order system, correct?

A Correct.

Q Now, let's assume that -- but California does use a finished product pricing mechanism to set its minimum milk pricing as well, correct?

A Correct.

Q It goes through the same mechanism the USDA does when costs of manufacture are alleged to have increased, namely, it holds a make allowance hearing, correct?

A It goes through a similar process.

Q Similar, but historically faster process, correct?

A Yes.

Q They have historically been more -- for whatever reasons, California has been able to shift its make allowance more quickly to reflect actually changes in the cost of manufacture?

A They have the ability to do that and have shown that they have done it in the past.

Q Now, the way California would address the situation that I've got up on the screen is that if they saw -- and mind you I'm not suggesting the costs of manufacturing are the same, or the make allowance is the same.

If they had a current make allowance of $0.17, I'm not suggesting they do, but just to make it simple. If they had a make allowance of $0.17 and they saw costs for their cheese manufacturers had risen by $0.3, the way they historically would address the situation is to increase the make allowance by $0.3, correct?

A Possibly. There would probably be a request to do so; whether they in fact do so or not, I don't know.

Q Let's assume that they had done so, just to make the hypothetical simpler.

Now, a California manufacturer under those conditions, where the make allowance has now gone up to $0.20, its minimum milk price obligation has dropped from $1.23 to $1.20, correct?

A Sure.

Q And so it is able to continue to charge $1.40 for its cheese and cover all of its costs, correct?
A Sure.
Q Now, surely you would agree with me that the presence of that collective 17 to 18 percent of total cheddar cheese production, having an ability to continue to sell at the $1.40, will present a material bearer to any effort by a manufacturer in the Federal Order system to extract additional monies from their customers?
A I don't know. I don't know if it will or not.
Q Now, Idaho is currently unregulated, correct?
A Correct.
Q And they, therefore -- we heard testimony from Mr. Davis as to how his plant in Idaho pays its farmers on various formulas.
A I missed that. I understand the basis.
Q So, if the Idaho processors of cheese, who are unregulated, are facing higher cost of manufacturer, they can -- they're under no regulatory constraints with respect to what milk prices they pay as a result, correct?
A Market determines the make allowance in Idaho and it's a negotiation between the farmers and

the plant; and it may go up, it may go down.
Q Certainly, the existence of that 16 to 17 percent of total cheddar cheese in the country that's made in Idaho, that provides a substantial damper on the ability of federally regulated cheddar cheese manufacturers to increase their cheese price; do you agree with that?
A No, because we don't know what the negotiation is in Idaho relative to determining the make allowance.
Q By the way, where has the growth been in cheese manufacturing in this country over the last 15 years?
A Probably historically in the western states. I think most recently in New Mexico, West Texas, and we know that there's a very successful California company making cheese in California that chose not to build their plant in California, but instead to build it someplace that the milk they would purchase would be under a Federal Order.
Q Under the existing Federal Order?
A Under the existing Federal Order in Texas.
Can I make a couple comments just based on

some of the conversation that we've had?

Q Maybe later when Marvin asks you questions.

A And I'm sure he will.

Q Let's just continue on. Under the scenario we've talked about, as we've said, the price of cheese is $1.40, and let's assume, hypothetically, I'm not suggesting this is actually going to work, but let's assume hypothetically that Federal Order manufacturers were able to convince their customers to have this $0.3 surcharge put on, and let's assume the price goes up to $1.43. I don't want to suggest I think that will work, but let's assume that happens.

Handlers in California or Idaho would have no incentive to start putting a $0.3 surcharge on, they could just charge $1.43, let's assume that that's what the market now is, that's just what the invoice would show, $1.43; do you see that?

A Sure.

Q Now, the NASS survey, I assume, is going to continue to pick up the prices being charged by Idaho and California handlers who meet NASS specs, right?

A Sure.
Q And so for those suppliers, what NASS would be reporting would not be the $1.40 excluding the $0.3 surcharge, but rather $1.43 under your proposal, correct?
A It could be, but they're going to fill out the same reports and so there would be an incentive for them to charge $1.40 plus $0.3 so that they can keep the $0.3, and it doesn't bid up milk prices.

I suppose on the other hand they will say if we can overreport, it drives up the Federal Order price; but they can do that now because it's not being audited, and maybe they are doing it now.
Q Well, that's the difference between lying and telling the truth. I'm assuming that people are reporting honestly, or should be, and hopefully they'll be audited at some point and they will be. We support auditing by the way. I hope that's clear.

But I think you've already jumped to my point. Actually, a California processor who is smart would realize I'm not going to put $1.40 plus a $0.3 surcharge for a total $1.43, I'm

just going to put $1.43 on my invoice. The reason I'm going to do it, I get the same amount of money, but by putting $1.43 on the invoice, I'm driving up the NASS survey price and, therefore, driving up the minimum milk price for handlers in the Federal Order system, who are my competitors.

Isn't that a pretty smart thing to do if you're a California manufacturer?

A It may be a strategy that they would employ.

Now, keep in mind if indeed we go to CME pricing, this whole discussion is moot. And we have already seen that on powder, even if you don't go to CME on powder, we have already seen that this system works the way I have intended it and Dairylea intends it to do, it's just that NASS picked up the surcharge.

So we've already got a real-life example where this has worked.

Q Well, let's talk about the -- you have three examples of surcharges. One example is the Dairy America example, correct?

A Yes.

Q Where Dairy America was able to include on its invoice an energy surcharge, correct?

A Yes.
Q But you've already said Dairy America is a monopoly?
A I did not say that.
Q Well, 75 percent of powder production is sold by Dairy America.
A I didn't say they were a monopoly.
Q Well, you're an economist, sir, every economist would agree that if there is one entity that controls 75 percent of a supply of a product, that's a monopoly; wouldn't you agree with that?
A Dairy America is a marketing agency made up of a number of cooperatives who have worked together to create efficiencies to sell their powder.
Q I'm not trying to be pejorative here. I'm just asking whether or not as a matter of economics, I'm not asking whether a matter of economics theory, just economics 301, would agree that if there is an entity that controls the sale of 75 percent of a product, then it qualifies as a monopolist.
A I think there are other extenuating circumstances relative to whether -- the term "monopolist" assumes there is some -- has a connotation that there is some sort of possible

market power that they have that is inappropriate, and so I don't like using that term.

There is a theory in economics called "perfectly contestable markets," and I would argue that there is a perfectly contestable market in manufacture of powder, even though there is one entity that may have 75 percent of the sales under its control.

Q By your own evidence --

A That means that markets work as they should, even though there is one entity that has 75 percent of the powder.

Q By your own evidence you have 168 cheddar cheese plants, 72 of them make a million pounds or more a year.

I'm looking at table 6 to Exhibit 54, correct?

A Yep.

Q And you will grant me that that scenario is hardly comparable to a situation that is existent today with respect to nonfat dry milk, where one entity is selling 75 percent of the total production?

A It's different, but it doesn't mean that the

cheddar side couldn't get there.
Q Now, your other example was, and I couldn't quite tell actually from your language, it's the mandatory -- I think you're talking about the milk pep program; is that right?
A Yes.
Q The reason I think actually they surcharge the milk pep program is $0.15 not $0.20 as your testimony suggested. It's $0.20? I'm sorry then, I stand corrected.

Be that as it may, my point really has nothing to do with the amount. That $0.20 was a mandatory cost imposed by law on all fluid milk handlers in the country, correct?
A Yes.
Q There is no one who didn't face that cost, correct?
A I guess. Again, on faith, yes.
Q Now, the third example you used, if I understood you correctly, was the Pennsylvania Milk Marketing Board fuel adjuster; is that right?
A Yes.
Q And I'm not an expert on the Pennsylvania state order system, but is that a mandatory cost in some fashion?

A Yes.
Q Now, let me get, then, to the relationship between your proposal 20 and proposal 15, which is the proposal to start using the CME to determine the --
A Okay.
Q -- value of finished products rather than NASS survey.
A Replace NASS with CME.
Q Right.
A Okay.
Q I'm not sure I understand how your proposal 20 and proposal 15 would work together if they were both adopted, so I'm really asking, at this point at least, just mechanical questions.

Now, are you assuming that you would use the CME -- so, proposal 15 would replace the NASS survey and start using the CME with respect to butter and cheese, correct?
A Yes.
Q And so let's assume that you've done that, the CME price is $1.40, and the make allowance is $0.17, we're in the same hypothetical as I gave you before which is up on the screen, so the minimum milk price is $1.23. USDA has announced

that the cost of manufacture is $0.3 higher than the make allowance, but as we've discussed, it's not -- doesn't have any regulatory effect, doesn't change the make allowance.

Now, would there continue to be a NASS survey of cheese and butter under your scenario?

A Sure, if I wanted to do that, you're fine.

Q But is it necessary to your scenario?

A It's not necessary for our scenario.

JUDGE PALMER: Just a minute.

(A discussion was held off the record.)

JUDGE PALMER: All right, back on the record.

A On the NASS survey, we would support more information as opposed to less, but it's not necessary to have it if you go to CME.

Q All right. So this notion of people having an invoice that has a certain -- let me back up.

If we assume the NASS survey continues to be used to set minimum prices, under your proposal, the reporting of the $0.3 as a separate surcharge is critical to the mechanism of your proposal, correct?

A I'm sorry, I was distracted.

Q I don't know. I don't know, you want to take a

break to see if we can fix it?

JUDGE PALMER: Let's take a quick break.

(A recess was taken.)

JUDGE PALMER: Sounds calm. Go ahead, Mr. Rosenbaum.

BY MR. ROSENBAUM:

Q Now, before we took the break, Mr. Gallagher, I was starting to explore with you the relationship between your proposal 20 and proposal 15, because your testimony suggests that they can both be implemented, and I think you've actually advocated that, correct?

A Correct.

Q As we've established, proposal 15 is the proposal that would stop using the NASS survey to determine what the price is of the manufactured products used to set minimum milk prices, and instead use the CME, to the extent possible, to do so, correct?

A Correct.

Q And butter and cheese would be two of the products for which that switchover would take place, correct?

A Correct.

Q I'll leave nonfat dry milk and dry whey out of

it for the time being; perhaps I won't even get to them at all for purposes of exploring how it works. So let's take cheese.

We're now using the CME cheese price of $1.40, under our scenario, to determine minimum prices, correct -- minimum milk prices to farmers, correct?

A Correct.

Q And you had under your scenario, where you were using the NASS survey to determine what the prices are of finished products. You were depending upon the invoices breaking out the surcharge separately, correct; that's how the system would work, correct?

A Correct.

Q It's only the breakout of the surcharge that would allow NASS to ignore that extra $0.3 in conducting its survey, which is --

A In my proposal, yes.

Q Which that's the driver of the proposal, correct?

A Yes.

Q Now, if the CME was now being used to determine the manufactured prices, there would no longer be any need -- would it be a matter of

irrelevance from a regulatory standpoint whether or not this separate surcharge is being broken out on invoices?

A Yes, it would be a matter of irrelevance.

Now I would say that if you have the CME used instead of NASS for cheese, you know, we're at different ends of the spectrum here relative to make allowances. We don't want any more make allowance changes and you do, and one of the reasons that we see there are make allowance changes is because we've structured a system that embedded in it is this circularity for a portion of the manufacturers in our industry and so that creates a need to have make allowance hearings and change make allowance.

So if we can take that circularity out, I think that removes a big -- a reason to have make allowance hearings and so -- but let me finish, though. But one of the things that still could be done, is you still could go through this process and report what the cost of cheese production is and how it has changed, even though you're not having any more make allowance changes, to assist the industry to pass those costs along.

So you still could do it.

Q I know there are circularity issues, which we may get into a little later, but I just want to understand right now the mechanics of your system under a scenario where USDA has adopted both proposals 15 and 20; that's what my question is trying to get at, how it would work.

We're now using the CME, and once again, the scenario is the price of cheese is $1.40, the make allowance is $0.17, the minimum price is $1.23, the actual cost of manufacturing is $0.20, okay?

A Sure.

Q And the price of cheese, we've adopted proposal 15, so when I say the price of cheese is $1.40, that's now based upon the CME as opposed to NASS survey, okay?

A Okay.

Q Now, if the price of cheese remains $1.40, then obviously manufacturers, because they have to pay $1.23 minimum milk price, are losing $0.3 a pound, assuming the make allowance is $0.17 and their actual costs are $0.20, correct?

A Most cheese is sold at CME or CME plus something. So there already is a plus something

in the system where they can get that back.

Q Well, okay, but let's see how this --

A It's already a pricing culture and practice. It goes back even to the question about will somebody allow the negotiation to be $1.37 plus $0.3 instead of $1.40 plus $0.3.

Jeez, I would hope that the manufacturers have a pricing custom that's based off the CME, so if that happens, that means they're giving that up. I don't think they'll give that up very easily or readily; they will fight to keep that pricing system.

Q Let's start with the scenario of outline that's up on the screen.

Now, if the CME price were to go up to $1.43, under a situation where we've adopted both proposals 15 and 20, the price on the CME goes up to $1.43, the make allowance is still $0.17, and so the minimum milk price obligations of the handler have now risen from $1.23 to $1.26, and therefore, we're still in the current situation where the increase in prices on the CME doesn't -- has to be passed on 100 percent to the dairy farmer; and, therefore, the process hasn't covered any of the additional cost of

manufacturing.

Tell me why that's not right and why your system doesn't die if proposal 15 and 20 are both adopted?

A Sure. A couple months ago the CME cheese price was $1.33 and now it's more like $1.43, so it's gone up $0.10, we've got entities out there that are pricing at CME plus.

If this program was in place now, they would be able to have an opportunity -- a better opportunity at getting some of those costs back regardless of how the CME price changes, up or down.

In your example, it goes from $1.40 to $1.43, that could be what could happen today on the CME exchange. So the sale would be CME plus, just like it is now. And you create the culture in the industry that the price is CME plus whatever it is, plus whatever this add-on is, and then it just all moves up the system in that manner.

Q Let's assume that a manufacturer right now, because of quality or other reasons, is able to be at CME plus a penny, let's take that example.

A Okay.

Q Now, so that handler under that scenario is having to pay $1.23 as a minimum milk price, it only has a $0.17 make allowance, so it's got a shortfall of $0.3, but it's able to make up a penny of that through its being able to convince its buyer to may a penny more.

Let's assume that's what's happening today with that buyer and seller, all right?

A Uh-huh.

Q Now, assuming proposal 15 -- but it's still losing $0.2, all right; that's my hypothetical, $0.2 a pound between its actual cost of manufacturer and $0.20, what it gets out of the $0.17 make allowance, and the extra penny it's actually getting for that cheese through its negotiation.

Now under your scenario, where we've adopted 15 and 20, if the CME price goes up by $0.3, to $1.43, the make allowance is unchanged at $0.17, the minimum milk price goes up to $1.26 and, therefore, the movement in the CME price has done nothing to help the manufacturer cover its $0.2 shortfall.

A Not necessarily. They can try to pass it along.

Q Well, but the movement in the CME price itself

simply calls for a higher minimum milk price on its own, correct; and has nothing to do with income received by the manufacturer after it's paid out that minimum price, correct?

A I'm sorry, say that question again.

Q The movement in the CME -- you described at length quoting from Dr. Yonkers how the rationing system works, correct?

A Yes.

Q You're in agreement that's how the system currently works, correct?

A In theory.

Q What I'm saying is if you started to base the whole system off the CME rather than NASS surveys, if the CME price goes up to $1.43, all that means is the minimum milk price goes up to $1.26, correct, and the manufacturer hasn't hung on to any money at all, any extra money?

A It depends on what their add-on on top of the CME price is.

Let me give you an example. Right now we know, from the NASS survey, again, we've had testimony from Upper Midwest manufacturers that say they price off the CME. If you look at the NASS survey and you look at what the cheddar

cheese NASS survey price is for the Upper Midwest, and it is typically $0.3 to $0.5 a pound more than what the national price is, so they're already pricing cheese at CME plus something that's more than $0.3.

Q And I assume --

A So there is a large margin of opportunity there and we're talking -- if you look back at my analysis, and certainly, you know, we're going to be all over the board as to what's the right make allowance change and what it should be, and never going to be as much as you want, probably going to be more than we want, as long as we have these hearings. You look at my stuff, it shows that on cheese we're talking about something that's less than a cent per pound would be the add-on.

I can't believe that when you've got somebody that's already pricing at CME plus a nickel, that they can't price at CME plus $0.53.

Q But your whole concept really is that by waving the piece of paper from the government, which has no regulatory impact, they can extract extra money that they are not currently extracting merely by holding this piece of paper from the

government; that's really your whole proposal.
A I'm not guaranteeing they can get it out of the marketplace, just like dairy farmers aren't guaranteed they can get their additional money out of the marketplace.
Q Dairy farmers have no minimum price obligations with respect to any of its input; isn't that true?
A Dairy farmers have to pay the price in the marketplace.
Q That's right. We're talking here about a scenario because of the minimum milk price system, manufacturers are limited as to -- that there's a floor as to what they have to pay for their milk; that's why we have this whole system.
A They can mitigate their costs. They can take measures to try to pass their costs to the marketplace, and they can negotiate with whoever they're buying their milk from to change the price that they are paying them. There is enough over the minimum price -- I mean, it's USDA's stated objective that they announce minimum prices, and they are not meant to be market prices; and we've seen over time

over-order premiums in the marketplace have gone up, and that will continue to happen. Over-order premiums over time are going to grow because that's the process that we're in.

Q I assume you would agree with me that the price being charged by California and Idaho cheese processors places a lid on the extent to which manufacturers in other parts of the country are able to raise their prices.

JUDGE PALMER: Let's take a short recess. I think we should just a moment until the end of the song.

(A recess was taken.)

JUDGE PALMER: Back on the record.

Q The question I was starting to get into was the ability of Federal Order regulated handlers, producers of cheese, to raise their prices is subject to the normal supply and demand -- it's subject to the existence of alternative suppliers of cheese; do you agree with that?

A Yes.

Q And it is subject to the existence of other competitive cheese manufacturers within the Federal Order system, correct?

A Correct.

Q And it is subject to the competitive impact of handlers in California or Idaho who are not part of the Federal Order system at all, correct?
A Correct.
Q And have there been some serious closures of -- have there been material closures of cheese plants in the Northeast since order reform went into effect January 1, 2000?
A There's been closures, reopenings, and expansions, and we are blessed with a lot of wonderful cheese manufacturers in our region.
Q The Kraft plant in Canton closed; is that right?
A Yes.
Q Lactalis in Goshen closed?
A Yes.
Q Saputo in Allentown?
A Yes.
Q Supremo plant in Ogdensburg?
A Yeah.

MR. ROSENBAUM: I think that's all I have for now.

JUDGE PALMER: Let me just see if I understood the pricing system here. We're talking about the $1.40, $1.23 that's on the board.

Cheese, that would be a Class III price in most of the orders?

A Yes.

JUDGE PALMER: So how would you get to the $1.23 under an order under a Class III price?

What would you look at, the NASS price then do what?

A They take the NASS price and they've got a formula, this is very simplified of what actually happens; it's a much more complicated formula. But they take the NASS price, they subtract off the make allowance so you get to the farmers actually receive in value $1.23 per pound of cheese and simply convert that to a milk price on the average hundredweight of milk would make 10 pounds of cheese, so that would be converted to a $12.30 Class III price.

Very simplified. It's more complicated than that, and actually doesn't come out to that number; but that's the basic process.

JUDGE PALMER: Okay. Questions? Yes, Mr. Yale.

CROSS-EXAMINATION,

QUESTIONS BY MR. BENJAMIN F. YALE:

Q Good morning, Ed.

A Good morning.
Q By the way, I'm asking questions for information because I don't know where we stand on this proposition.

One of the questions that I do have is, is that, as you know, there is a proposal before the Secretary and there's been testimony from a number of witnesses, one way or another, in support of it of using the CME for at least two of the four products.

A Yes.
Q Does Dairylea have a position on just using the CME?
A We support using the CME on butter and cheese, and we're -- we need to think some more about the other two products.
Q All right.
A And I think it's great that this is being debated and discussed. I spoke to the Dairylea board about this back as early as August, and one of the considerations we had was a proposal that we would submit saying we should use CME instead of NASS. I kind of talked myself out of it, saying it would never be something that would see the light of day to be considered and

discussed. So I commend the Department and I commend you for making the proposal and allowing it to be heard. I think it's appropriate.

Q We appreciate that. I think this is a great place for this discussion.

Now my follow-up, though, is, is that what we have with the CME, as an economist and in ag, you understand how reference market prices work in terms of actually what's being sold?

A Yeah.

Q That's a reference price plus or minus some basis that's negotiated?

A Correct.

Q And the CME, you have that price and then people negotiate for whatever, quality or aging or full fat or whatever; I mean, all those factors could enter, location, you know, supply and demand, all of that works in there, right?

A Correct.

Q And the NASS capture that basically on the cheddar?

A For those in the survey.

Q Those in the survey captures that, and so all of that basis gets added into the costs, regardless of whether the plant that is buying that milk

has that basis or not?

A Correct.

Q Now, what you're proposing to do, and I think in simple terms, and tell me if I'm right or wrong because, as an economist, you certainly have a better idea of this than I do.

Are we not trying to allow NASS to have a basis that isn't captured by NASS?

A Yes.

Q That's down and simple what you're trying to do?

A Yes.

Q Now having said that, are we creating a risk that the NASS will now become a reference price instead of the CME?

First of all, let me take out the word "risk." Do we create the situation where the NASS will become the reference price?

A It hasn't to this date, so I don't know. Again, the industry has had seven years almost to choose what they wanted for their reference point, and their reference has not changed away from the CME to my understanding.

Q And part of that is --

A At least on cheese.

Q And part of that is, is that the policy of

pricing at the vat or pricing when the cheese is made, and the NASS has a lag to it?

A That could be the reason, sure.

Q We have a lot of proposals before the Secretary, and as you've noticed, I think you're number 20 or something like that, and some compound or interact differently with different other proposals. And then we also have -- well, we have this energy adjusting for national milk, I want to discuss that in a second and how you're playing those together.

But let's just go for the moment that using, I think it was Bob Wellington's proposal, Agri-Mark's proposal that is trying to eliminate the lag from the CME to the NASS, you know, to kind of get it a little bit closer.

If we get to the point that that's taken care of, does that take away some of the reticence of using the NASS as a reference point; and if it does -- let's just assume that that might. But if it does, do you see that as a problem if NASS becomes a reference point?

A I don't think it's a problem if NASS is a reference point. It already is a reference point for powder, and the world hasn't imploded.

Q You don't see that as a problem?
A No, it's not -- I don't want to get into the Dairy America business decisions.
Q I'm not going to ask about Dairy America.
A It's not that it's a reference point, I don't think that it's a problem.
Q Okay. Let's talk about National Milk's proposal.

Now, you've set up, and I think very wonderfully, this concept that if the manufacturers have inflated costs, right now the system appears to be the only way is that they have to go down and take it from the producers, right?

A Through a make allowance change.
Q Through a make allowance, which means reduced income to the producers, right?
A Yes.
Q And at the income level for the producers, they are also probably suffering the same inflationary pressures as the plants, right?
A I think it's well documented in this hearing that they are.
Q The only place they can get it out of is the market, which we just now said is going to pay

them less, right?

A Right.

Q So you want to turn it around and shove everything from the producers to the processors, processors to the consumer, right?

A Yes.

Q The National Milk proposal, with the indexing, I'm not talking about whether you index or not, okay, the question is, with the proposal the way it is right now, it would increase the make allowance and reduce the producer price, right?

A It could.

Q Offset, you're absolutely right, I mischaracterized.

A It could go both ways.

Q As a lawyer, I'm always looking at on the bad side. The positive side is --

A It could go both ways.

Q It could go both ways.

Which kind of counters Dairylea's policy?

A Yes.

Q Right. So are you suggesting that the National Milk proposal be adopted as one that in fact changes the make allowance, or instead should it be if your proposal's adopted, be part of this

cost add-on?

A No, we are supporting the National Milk proposal in addition to our proposal, so you would have the National Milk proposal that would go in and update the make allowance as being proposed, and that any increase would be backed out of whatever the cost add-on would be before it would be announced.

And if it consumed all or more than whatever the cost add-on would be, then the cost add-on would be zero.

So, for instance, if the -- we went through this process and we used Steve's example that it was $0.3 a pound for cheese and you went through the National Milk proposal and the make allowance would increase $0.2 a pound because of energy, then the add-on would be $0.1.

Q Okay.

A If the National Milk proposal was $0.3, then add-on would be zero. If it was $0.4, the add-on would be zero.

Q Okay. But in all of those cases, the make allowance would go up and the producer price would go down subject to whatever the plant would pay, right?

A Yes.
Q This is an unfair question, but I'm going to ask it anyhow.
A That's all right; I'm a big boy.
Q We're friends. Are you wedded to the idea of not adding the National Milk proposal as being an automatic component of your adjuster as opposed to a change to the make allowance?
A Dairylea Cooperative has adopted a policy that supports the National Milk proposal. I can't veer from that right or left in any way.
Q Okay.
A Without going back and starting the process over again.
Q And I wasn't asking to do that. I was just trying to see how wedded that was. I think you've answered that.

Now, you talk about the auditing, and I think there's been some evidence and discussion and all that suggest that the Secretary clearly had the authority to audit these surveys necessary to do the make allowances, right?
A Correct.
Q But I think if you read the statute, it says Classes III and IV.

A Correct.
Q Which right now doesn't make a difference because we have an advanced III and advanced IV so, therefore, it works for our Class I and II prices, right?
A Correct.
Q There is another proposal that's pending now regarding changes to the I and II formula. We don't know where that's at, but my question is, it's really twofold, one, if they continue to use some form, even indirectly, of the make allowances in establishing that level of the, you know, in that formula I and II, is this to be incorporated into that? That's my first question. Is this adjuster to be incorporated into the I and II portion, if it gets decoupled?
A We do not want increased make allowances to lower Class I or II prices.
Q Okay. Very good. That's the point I wanted to get across.

The second part of that, though -- well, then that takes care of it. Then they would not be linked to the adjuster right, or yes? I mean --

A If they can find a way to use it, God bless them

and all power to them. We want to help them pass their costs on.

Q Unfortunately, it's kind of a line of questions that Steve was asking and maybe trying to get to the same point, but I think it's a market-wide important one, and that is: If you have -- let's use the example of the milk pep program where there's a $0.20 per hundredweight that basically all plants in the country have to pay, so I know I'm passing on to the consumer because you're passing on to the consumer, and by law, everybody else has to pass it along, right? I mean, there's a beauty there because everybody knows they're in the same playing field, right?

A There's nothing that guarantees the processor, though, that they can pass it on.

Q I understand that. But if everything else being equal between the plants, they can pass it on because competition's going to have to do the same thing.

A Yes.

Q Okay. If you have a plant -- let me just use the example -- that's producing cheese today at $0.14 a hundredweight, okay, and we've got a

make allowance of $16.82, I think is the right number.

A They're producing at $0.14 a hundredweight?

Q $0.14 a pound on the make allowance. It's a very efficient plant.

A Production cost is $0.14 and make allowance 16.8.

Q Which already gives them the 2.82 spread that they can use either to pay for more milk in the field that offsets a lot of that in terms of what the other plants have to pay, or reduce the price they sell their product for.

A Or keep it for profit.

Q Or keep it for profit, and maybe build another plant someplace else and increase the thing.

A Right.

Q If a plant feels that it needs the additional surcharge because its costs have gone up, and the $0.14 plant hasn't changed, we really haven't solved anything with that plant that is having that higher cost to produce, have we?

A I don't know. It depends on the market dynamics and the supply and demand and the competitive situation.

Maybe or maybe not; I don't know. It's not

much different than somebody that's producing milk in West Texas at a cost of production that's probably a couple bucks or more a hundredweight less than somebody in the Northeast.

Q I think which may be somewhat dispelled today, but I understand the sense; and it was a time it was a very sufficient place compared to others.

Taking that to the next step, Mr. Rosenbaum asked the question about California because they can supposedly, if there's this nationwide surge in cost for plants, the plants out there could get a quick make allowance there and raise that; so they could offset -- they can create all kinds of, you know, destabilizing market conditions, I guess, and pass that -- and somehow or another impact the NASS because they're reporting to the NASS, okay, right?

A Yes.

Q We have the same situation in Idaho; you've got plants that are reporting to the NASS.

A Yes.

Q And I don't see it in here. Have you considered the possibility that if you're going to do this, that the reporting, for purposes of setting

these prices for Federal Orders, we look at just the plants that are within the scope of the Federal Orders as opposed to others?

A That's an interesting concept. I haven't considered it and I wouldn't want to comment off the cuff right now without thinking about that for a while.

Q Okay.

MR. YALE: I don't have any other questions. Thank you.

JUDGE PALMER: That ended so soon. Yes, Mr. Smith.

CROSS-EXAMINATION,

QUESTIONS BY MR. DANIEL SMITH:

Q Good morning, Ed.

A Good morning, Dan.

Q Dan Smith with the Maine Dairy Industry Associates.

I would like to ask you a general question first with regard to your proposal. Is the motivation for the proposal prompted by what you described before in a hearing such as this, processors are looking for more in terms of the quotient for the make allowance and the farmers would be advocating for less, so it's a question

of the relative shares available to the processors and farmers; or is your proposal prompted by a larger concern with regard to the overall impact on the producer price of which this is only one increment?

A It's a little of both, Dan. Little of both. Certainly concerned about the overall impact, and we're also concerned about the overall share. You know, who knows, within two years you could have a deregulated Upper Midwest marketplace if certain things happen and the cooperatives get upset and they vote the order out.

When that happens, what I'm laying out and what Dairylea is laying out in this proposal is the real world. And who knows how the dominoes fall after that. And it's not out of the realm of anybody's imagination that 10 years from now, the Federal Order process just may not be able to function anymore. And we look at that at Dairylea as a business risk to our cooperative, our members, and our industry in the Northeast.

And we are recognizing that we need to address situations in Federal Orders to make them as much as we can, and still retain the

benefits that they provide, but as much as we can, a program that's more like the real world; and I think this is a step in that direction that creates a cultural practice that maybe can carry on if there were no longer Federal Orders.

In fact, I think in the Upper Midwest Order all kinds of suggestion that they were going to vote it out at the last referendum, I think this is what would happen is this proposal.

Q Along that line, you testified before that in the Upper Midwest, the pricing was CME plus upwards of $0.5?

A I can't remember the exact number, but there's some differential you can extrapolate out of the dairy product price survey, and it's obviously CME plus something more than of center to.

Q Something on that order of magnitude, though?

A Yeah.

Q And your proposal suggests that the increment that you have identified would fit easily within that amount?

A Yes.

Q Do you think that that is a representative amount of what's available in the market in terms of the larger market than just the

Midwest, or is that just specific to the Midwest?

A I don't know. I've got to believe that the -- I don't know, Dan. I don't know if you look at just the NASS products, I would say that there's not that much of a differential, but then I don't know what the pricing markup would be on the product that's not in the NASS survey.

Q And following up on that question, your tables indicate pretty clearly that the NASS reporting is a relatively insubstantial volume of the total milk, cheese -- total volume of cheese production in the country; is that correct?

A Yes.

Q So more generally, you've indicated that you think the margin can absorb this minor increment, and certainly against the one calculable number from the Upper Midwest.

Is your sense that because there is such a small percentage of the NASS reported product as compared to CME, that generally the margin is more open to absorb higher costs that the processors could pass on?

A Jeez, I would hope so. I don't have a definitive answer for that; I'm not close enough

to the situation.

Q Mr. Rosenbaum asked you about the impact of the California pricing series against the Federal Orders pricing series and its impact on the margin.

Given the volume of milk that's produced in California, do you see that as a concern for your proposal as Mr. Rosenbaum was asking you?

A No.

Q Why do you not see that?

A There's already a differential between west versus east and the California system versus the Federal Order system.

There's already been interactions in the marketplace where an equilibrium of some sorts has been developed. I don't think this is enough to make that equilibrium change that much.

Q Are there any other factors affecting that equilibrium at this point other than the make allowance? Are the component prices in alignment to the extent that that element of the pricing equation between the two regions is in equilibrium and the only moving factor is the make allowance?

A I'm not sure.

Q Let's switch subjects to the testimony of your board member yesterday, Mr. Beeman, and the testimony by the plant manager with regard to the milk supply for the Northeast.

The testimony was that the plant had sufficient milk looking forward. Can you comment on that with regard to the milk supply for the Federal Order?

He indicated he was not aware of those statistics. I assume, given both your prior employment and your current situation, that you're more familiar with the statistics.

A What's the question?

Q The question is: Do the statistics show that the milk production in the Northeast Order is in fact stable or is it in fact starting to head down?

A I'd prefer Dan to answer that based on the -- not the milk production in the Northeast Order, but the milk production for the Northeast because there's movement of milk that go out -- that don't get captured by the Northeast Order.

Q Let's start with that and move into the milk

that's moving in.

A Production for the Northeast declined slightly during 2006. It was up early on and down towards the end of the year, and it continues to be down right now.

That situation will not correct itself, at least until there is a new crop of forage when it may correct itself and start to increase again. I think long term with the investments that will be made on dairy farms in the Northeast, we are going to see a growing milk supply in the Northeast that will grow by a billion pounds in three to five years, another billion pounds in another three to five years after that.

Q In the last few years, what has been the percentage of milk that's moved into the order as a percentage of the total supply for the order?

A It's been pretty small.

Q "Pretty small," what percentage?

A Probably less than one percent.

Q The milk moving in from outside the order?

A Yeah. I've got to tell you I don't have the statistics; the statistics are published by the

MA. If you show me them, we could look through it and figure it out very quickly, but it's not very much milk at all.

We are bringing in organic milk from Michigan, but that's not any great amount that in the grand scheme of things is very large.

MR. SMITH: Thanks, Ed.

JUDGE PALMER: Mr. Beshore. Any questions over there? Oh, there's some questions over there.

Mr. Vetne, yeah; come on up, Mr. Vetne.

CROSS-EXAMINATION,

QUESTIONS BY MR. JOHN H. VETNE:

Q John Vetne for Agri-Mark, et al.

A Hi, John.

Q Good morning, Ed.

Okay. Thank you for your innovation.

A You're welcome.

Q You commented that your overall philosophy in approaching regulatory issues is to have the system work more like "the real world"?

A As best we can to maintain the benefits of the system.

Q Okay. There has been a -- in prior decisions of the Secretary, the Secretary has expressed the

view that regulated pricing should reflect the competitive market.

Are you using basically the same concept as expressed by USDA?

A The regulated price doesn't reflect the competitive market, no; there are significant over-order premiums. So, no, I'm not suggesting that it should reflect the competitive market.

Q Okay.

A It should respond to supply and demand, if that's what you mean.

Q Okay. The surcharge concept that you have is one that would apply only to NASS survey pricing, it could not, under current terms of trade, apply to transactions on the CME?

A Correct.

Q And it could not, under current terms of trade, apply to transactions with the commodity credit corporation?

A Correct. It could be changed to do that, I suppose, if you wanted to, but, correct.

Q So, let's see, in Mr. Rosenbaum's example, the price of cheese is a price that's reported for regulatory purposes under your proposal, reported by USDA for use in the system, correct?

A Correct.
Q And in that example, also, then, the undisputed cost of converting milk to cheese went up from $0.17 to $0.20.

In your proposal, processors in the aggregate could attempt to negotiate the $0.3 increase as a line item, and if that was done, USDA would be permitted to announce the price of cheese at $1.40 rather than $1.43, which includes the line item?
A Correct, for those in the survey that were able to pass it along.
Q Who were able to negotiate that line item?
A And show that they could negotiate it through a separate charge on the invoice.
Q Okay. For processors having exactly the same circumstances, who sold on the CME, you have a suggestion for a mechanism for including that surcharge in a reported price or the component of the reported price represented by the CME transactions?
A I don't, no.
Q Would it not work the same if USDA simply developed a surcharge amount and applied it across the board and announced the cheese price

at X minus surcharge?
A No.
Q And why would that not?
A It would automatically push the price back to farmers through a lower cheese price.
Q Because it wouldn't capture, for example, California transactions or Idaho transactions where there would, under your proposal, be no real incentive to negotiate a line item?
A Or even on -- if we had -- let me back up, John. Maybe I'm confused in your question a little bit.

My answer was if we had CME replace NASS and CME do this, then -- I guess it doesn't matter. Since the basis for pricing in the industry is CME, we would not want CME to adopt some sort of a proposal that took the CME price and subtracted some value from it.

Q In the real world, to the extent the real world is reflected in the NASS survey, there are additions and subtractions that go into the NASS reported price, additions and subtractions from CME on cheese?
A I'm sure there are, but I can't quote any, but I'm sure there are. I can quote the one that I

gave as an example for Dairy America.
Q And you also referred to subtraction off the CME price for cheese delivered to the west, for example?
A I didn't.
Q You didn't?
A No.
Q Okay. Are you aware of that?
A I'm generally aware that there is a discount. The trade is a discount from the CME, yes.
Q The CME reports a price as if delivered to the Midwest, the invoice for the transaction, in fact, if delivered to Washington or the state of California, would reflect something less?
A It might; I don't know that. But generally, I've heard that it does.
Q And assuming that it does, when the NASS does the survey, it picks up the discounted price of the actual transaction, not the bid price pretending it was delivered to the Midwest?
A It would pick that up, yes.
Q And I had a couple of questions on the interaction of your proposal with the NMPF energy indexing proposal.

You gave a series of examples, again, using

the $0.17 make allowance. If there were a $0.3 increase in manufacturing costs, and $0.2 were attributed to change in energy, that $0.2 portion would be reflected in a $0.2 increase make allowance leaving one penny for your surcharge?

A Correct.

Q Okay. And if there were a $0.3 increase in energy, all of the surcharge would be absorbed in that energy component, which is indexed reducing the make allowance not allowing a surcharge component?

A Correct.

Q And if the NMPF proposal were not adopted, which is one scenario we didn't discuss in prior examination, and all of the increase were attributable to energy, but there is no indexing in the make allowance, the surcharge that you propose would accommodate all of the -- is the only place at which all of the increased energy cost could be accommodated?

A Yes.

Q Okay. Now, you gave the example, which has been referred to several times, of the Dairy America attempt at making a surcharge, as how this might

work beneficially?
A Correct.
Q And as you indicated, Dairy America is a group -- I'll avoid using the word "cartel" or "monopoly" -- a group of cooperative associations that make nonfat dry milk and sell that dry milk collectively through the agency called Dairy America?
A Correct.
Q And in your case, the manufacturers of nonfat dry milk collectively attempted to add a surcharge and have it not be included in the NASS survey?
A I would assume that was their intent.
Q Okay. But nevertheless, it was included?
A Yes.
Q And under your proposal, it would not be included?
A As long as it wasn't more than the regulated cost add-on.
Q Okay.
A So, for instance, if in the example it was $0.3 and they tried to pass on $0.4, $0.3 would be credited, but $0.1 would be added back into the price.

Q Well, the $0.3 would be a judgment determination by USDA that that in fact has been an increase in the costs?
A Correct.
Q Now with respect to a more diverse market of manufacturers and sellers, such as butter makers and cheese makers, is there a similar way that you suggest that those organizations can get together collectively and determine a surcharge the way Dairy America collectively provided a surcharge on 75 percent of the powder being sold?
A You know, I don't know what the proportion of the cheddar cheese would be, but certainly the dairy cooperatives in the United States could form an agency, if they chose to, to do something similar to what Dairy America is doing.
Q Well, Dairy America, in addition to developing this surcharge sales -- are you suggesting that the cooperatives together could develop a surcharge agency to collectively ascertain increased cost and collectively include the same line item on their invoices?
A I believe they could.

Q Okay.
A I believe Capper-Volstead allows them to do that.
Q You're referring to Capper-Volstead anti-trust partial immunities?
A Correct.
Q Is it correct to infer that the participation of noncooperative cheese makers would be precluded?
A Yes.
Q Would it be correct to say that for cheese making, the noncooperative portion doesn't come anywhere close to the 75 percent of supply represented by Dairy America in nonfat?
A Probably, yeah.
Q Okay. That's all I have, thanks.

JUDGE PALMER: Mr. Rower.

CROSS-EXAMINATION,

QUESTIONS BY MR. JACK ROWER:

Q Good morning.
A Good morning, Jack. And by the way, thank you for -- I haven't had the chance to thank you publicly for sending out the supplemental hearing notice that allowed our proposal to be heard today. We appreciate that tremendously.
Q Thank you. Ed, how would you envision the

additional auditing activities of proposal 20 to be funded, through the existing user fees through the existing assessment?

A To the degree we can, we would seek your advice on that. Let me explain.

First of all, there's going to be some auditing that's going to go on anyways, and I would say the same way that is funded; and if this is adopted, and you tell us you need additional funding, then we would work with you to secure that funding.

Certainly, you know, from my market administrator friends, they may look at me a little differently, but I don't think the additional cost of this for the auditing is going to be that significant that it's going to be that big of an expense item. Because I think the auditors are in the plants.

It's a different situation for California. I don't know what you do there, but --

Q I can't speak to California auditing activities.

Have you considered what additional staffing would be required? There are funding requirements, but also the staffing requirements there's just more time required.

A I think -- again, I think there's probably the people in the system already that can do it. And again, if you're saying there aren't, we will work with you to get the staffing and the funding that you need to implement this.

Q Thank you. Ed, would it be accurate to say that proposal 20 requires the Department to regulate market-determined sales prices by requiring manufacturers to pass along this cost portion?

A No, it wouldn't be. You aren't requiring anybody to do anything. You're just saying if they do, and it's less or equal to the add-on, we're not going to pick it up in the NASS survey.

So there's no extension of regulation to the wholesale price.

Q Okay. Thank you. Would the value of the cost add-ons or surcharges in proposal 20 be excluded or included in a processors accounting to the pool by excluding the surcharges from the price formulas?

A There would be no impact on the pool. The class price would be -- whatever you ended up using for the NASS product price survey would go back into the calculation of the class prices. You'd

calculate the class prices, you'd calculate the obligation that a plant would have to a pool; and I don't see how this would impact that.

MR. ROWER: Okay. Thank you, Ed. That's all the questions we have.

JUDGE PALMER: Mr. Beshore.

REDIRECT EXAMINATION,

QUESTIONS BY MR. MARVIN BESHORE:

Q Thank you. My first question on redirect, Ed, is what did you want to tell Mr. Rosenbaum that he deferred to me?

A I think I got it all in. I wanted to mention a number of things.

One thing I would say, you know, with Dairy America, if you look at -- unfortunately, if you look at cheddar cheese, what's produced here is mainly a domestic production. Hopefully that'll change.

Q A domestic sale?

A Domestic sale. If you look at powder, you can count up, you know, whatever it is, 75 percent of the powders produced by the entities in Dairy America, but they're selling in a world market and they're selling against a lot of powder manufacturers all across the world. I think you

have to look at the amount of powder they have in relation to the amount of powder produced in the world in their instance, because they have a lot of international sales.

Q If I can just follow through on that point a little bit.

Is it your understanding that the NASS data for powder sales, in fact for all sales, are product sold FOB the plant?

A Yes.

Q And, therefore, since Dairy America exports powder, that captures within it the FOB plant price for powder sales that are going all over the world?

A Yes.

Q So if you're talking about 75 percent of the reported NASS price, that's not the market that Dairy America is selling in.

A Correct.

Q Do you have any idea what Dairy America's share of production in the world market for powder is?

A That's a good question, I don't, though.

Q Are they a monopoly in the world powder market?

A I would not consider them a monopoly at all.

Q There's been a lot of -- there were a lot of

questions from Mr. Rosenbaum and some from others about the current relationship of NASS prices -- and I'm talking about cheese now, limited to cheese -- NASS prices in Federal Order system versus production in California and the western part of the United States, and how those prices relate and how they would relate to the CME, okay?

A Yes.

Q I want to further that discussion a little bit, but I want to further it in reference to the actual published prices in the dairy products prices, NASS publication for April 2007, and I'll just take the last week in that there are five weeks in that publication, but just take the last week and I want to give you --

A The most recent week?

Q The most recent week, okay?

A Yep.

Q Which is the week ending March 31, 2007, and I would like you to note these prices, and this is for 40-pound blocks of cheddar cheese, okay.

Now, first off a number that's not in the NASS -- not in this publication, but assume this is correct. The CME price for 40-pound blocks

average for the week that ended Friday March 30th, was $1.41, okay?

A Yep.

Q The NASS reported average selling price for 40-pound blocks in Minnesota and Wisconsin for the week ending March 31, 2007, was $1.4957, okay?

A I got it.

Q And the NASS reported selling price for 40-pound blocks in all other states was $1.3664, okay?

You got that?

A Got it.

Q Now, what observations, comments, might you make with respect to that configuration of known sales prices?

By the way, the CME prices for the same period.

A Yep.

Q They're contemporaneous; there's no lag issue here.

A Okay. I would say the following: I would say probably for that week the reported all other areas, the product pounds are primarily from the west, if there's some product pounds from any other area, the predominant product pounds would

come from Texas, likely, there is none of any significance from the north central or Atlantic area, if any; and so that would be a western price of about $1.366, versus an Upper Midwest price of $1.496. So that would show that the CME pricing in the Upper Midwest would be CME plus about $0.86s and in the west it would be CME minus $0.44, and that the Upper Midwest has been able to compete with the west by having a $0.13 per pound cheese difference.

Q Okay. Now, every week that difference may be a different amount; would you agree?

A Correct.

Q And if we had annual numbers, we could look at those averages and all, correct?

A Correct.

Q But does that reflect -- does that scenario reflect the fact that under current market conditions, there is a competitive relationship which allows producers in the Upper Midwest and, presumably geographically to the east, to compete with the large sources of production in the west?

A I would say that it does.

Q Would your proposal 20 do anything to

materially -- if it were adopted -- materially alter that competitive relationship?

A Not materially.

Q Let's talk about some terminology and make sure it's clear here when we talk about CME prices versus other prices.

You've used the term and Mr. Yale used it in questions to you, "reference price." Can you define that as, you know, as an economist and ag economist?

A I hope I'm going to use the same definition as he meant, because we didn't discuss that, but "reference point" would be the base price that people are pricing off of.

So the reference point that exists now is the CME price when selling cheese.

Q So the CME price presently, it's your testimony, is a reference point price for cheese transactions?

A Yes.

Q And you've heard the testimony from a number of people yesterday, maybe the day before, number of cheese processors or manufacturers that, for instance, Mr. Dryer from Saputo, did you hear him?

A I didn't, but I read it before I got out here. See, pre-submission works, right? Sorry.
Q Essentially, it was that a large share of the cheese marketed in the country is priced with reference to the CME block market.
A Yes.
Q And is that your understanding?
A Yes.
Q And that's, then, sometimes referred to as a "reference price"?
A Correct.
Q Is that the same as a transaction price?
A No.
Q Does a transaction price include a reference price plus what you refer to sometimes as a "basis"?
A Yes.
Q Now, could you define "basis" in that context?
A Basis in this context would be the difference between the actual sales transaction and the reference price.
Q And when you use basis in that context, you don't -- it's not the same base when you said the CME would be a base price?
A Correct.

Q Basis is a term of art?
A It's a term of art, yes.
Q Where transaction prices are the product of the reference price plus or minus a basis?
A Correct.
Q Now, the prices in the NASS survey for the week of ending March 31, 2007, that we just talked about, do they reflect that prices in Minnesota and Wisconsin were CME plus a basis?
A Yes.
Q And the prices in the west, and let's assume, as Mr. Rosenbaum suggested, and I think it can be documented well, that the majority of that production is in California and in Idaho, not affected by federal regulation, but the majority of that production now is priced at CME minus.
A Correct.
Q So their basis is CME minus. Would you expect -- if proposal 20 was adopted, would you expect that pricing for that production that is not affected by Federal Milk Order regulations directly, would you expect that the pricing for that production of cheese would change in any way because of proposal 20?
A It might go up a little bit, but probably not

change in any way.
Q Okay. Is a basic difference between using the CME and using the NASS for Federal Order pricing, that if the CME block market was used as the price, the basis in transactions is not captured in that price, the basis as we've discussed it?
A Oh, correct, correct.
Q And you just have, then, as a Federal Order price, the reference price?
A Correct.
Q Whereas, when we're using the NASS prices as currently, the prices that are included, then, in the Federal Order minimum price include both the reference price and the basis in the transactions?
A For the products that are in the NASS survey.
Q Yes, for the products that are in the NASS survey.
A Yes.
Q And that is what embeds the circularity problem in the system presently?
A Yes.
Q And the fact that the basis would not be used if you were using just the CME reference price or

Federal Order price, the basis part of the transaction price is not used, would take the circularity out of the system?

A Yes.

Q In that full context now, going to Mr. Rosenbaum's hypothetical, since we know the system, the testimony in this hearing from you, from cheese manufacturers, is that the system works off the CME plus or minus a basis, okay; that's how transactions are presently structurd, correct?

A Correct.

Q And that's what we see in the NASS-reported prices?

A Correct.

Q Now, that being the case, looking at Mr. Rosenbaum's hypothetical, in order to go to $1.37, if a CME price is $1.40, which was the assumption, if someone wanted to go to $1.37 plus 3 under his hypothetical transactions, would they have to change, in essence, their way of doing business?

A Yeah, they would stop using the reference point as the point of making their pricing decision.

Q They would have to change their --

A They would have to move away from CME plus basis pricing, which I don't think will happen and wouldn't happen without a fight from the manufacturers.

Q Just one other question relating to footnotes. If you look at Exhibit 10 to your Exhibit 53, which is the class price announcement from Order 5.

A Yeah.

Q The processor assessment, $0.20 processor assessment which is shown on here, you've indicated this is an example of how proposal 20 could work with respect to manufactured product prices, correct?

A Correct.

Q Now, the suggestion was made that all processors must pay that $0.20; is that in fact correct, given the footnote on the document?

A Well, give me a moment to read it. No, if you process less than three million pounds of fluid milk products in consumer-type packages in the 48 contiguous states and the District of Columbia, then you are excluded from paying the $0.20.

Q And do you happen to know -- would it not be

true that there are a number of such processors in any given Federal Order?

A There are.

Q So that the hypothesis of $0.20 applies to all processors and all sales is incorrect?

A I stand corrected, yes; that's incorrect.

Q And in fact, as you did testify, however, it does not have the force of law in any way, shape, or form to the fluid milk buyers, correct?

A Correct.

Q But the publication of it -- it's your belief that the publication of the number has assisted --

A It's validated the cost in the marketplace and allowed the processors to pass it on.

Q And you would believe that the same could occur under the adoption of proposal 20 with respect to those products?

A Yes.

MR. BESHORE: Thank you. No further questions.

JUDGE PALMER: All right. You have another question? Let's take a break for five minutes and then we'll return to this witness.

(A recess was taken.)

JUDGE PALMER: Back on the record.

I think you had just finished questioning.

MR. BESHORE: I did but --

JUDGE PALMER: You have one more question?

Go ahead, Mr. Beshore.

BY MR. BESHORE:

Q Mr. Gallagher, do you have experience with the Pennsylvania Milk Marketing Board in a situation where the regulated system contemplates costs being pushed forward?

A Yes, I do.

Q And in contrast to the great contention between producers and processors in these proceedings with respect to make allowances, is there a more efficient and less contentious process of determining manufacturers' costs in that system?

A Yes, there is.

JUDGE PALMER: Could that be because Mr. Beshore is a common influence in Pennsylvania in those hearings?

A You're right, Your Honor.

A

JUDGE PALMER: Who else has some questions?

Mr. Vetne.

RECROSS-EXAMINATION,

QUESTIONS BY MR. JOHN H. VETNE:

Q John Vetne, representing Agri-Mark, et al.

Just a couple questions on follow-up of the redirect. I think Mr. Beshore referred to processors, maybe the word manufacturers for the Pennsylvania component.

What he was talking about there was the cost of fluid milk plants included in the state regulated system?

A Yes.

Q Okay. In that system there are, of course, a number of regulated prices, including a regulated mark-up; is that correct?

A Yes.

Q And fluid milk sales in Pennsylvania are set at the minimum level so that manufacturers are guaranteed a certain margin, or processors of fluid milk?

A Yes.

Q And there is no issue in that process with respect to circularity, it's simply looking at the manufacturers' aggregate processing costs?

A Correct.

Q You were asked some questions about prices

reported by CME and by NASS for the last week of March of 2007.

The CME was for the week ending March 30, the NASS was for period ending March 31. Do you know if there were some transactions not captured in those two? Were they totally overlapping or maybe a little bit tail end or front end that was different?

A Insignificant probably, if there was an overlap.

Q Okay. The reported NASS price, of course, is an average of the prices that Mr. Beshore referred to, an average of transactions in the Midwest at $1.49?

A Right. He didn't report the actual NASS price that would have gone into the calculation.

Q No, he didn't. But my question is: It's an average of those two, a weighted average?

A A weighted average, yes.

Q And the NASS survey price tends to come in a little bit below the CME price?

A Okay.

Q Is that true?

A I haven't looked at it recently to that regard. Wait a second; yeah, it does. I'm thinking about how I forecast prices and, yes, it does.

Q So the NASS price captures a portion of the basis that is represented by -- and the weighting process captures the basis which is CME minus for sales outside of the Midwest?
A Correct.
Q For sales actually in the west?
A In the west -- well, who knows where the product goes, but it's produced at plants in the west.
Q And that product is generally reported at a price at the plant from which it goes?
A Yes.
Q The proposal, proposal 20, would provide a reference price from which add-ons could be -- upon which add-ons could be built?
A The add-ons would be built onto an existing reference point. We're not creating a new one in my mind.
Q Right. But the NASS price, as whatever the reporting is, as adjusted by the add-ons.

It would be a reference price in a similar way?
A Correct -- wait, let me back up. No, because, again, at least for cheese, sticking with the cheese example.
Q Stick with cheese, please.

A The pricing reference point that the industry uses is CME. So it would be CME plus something, plus the add-on, which gets picked up in NASS.

For Dairy America, it would be NASS would be the reference point.

Q Okay. Now, the minimum price that we're ultimately here about is the price for which manufacturers account to producers or to a producer pool?

A Yes.

Q And that is a price at the farm level upon which add-ons are also built in the competitive world, like --

A I'm not following.

Q Well, like cheese price as reported by CME plus a few cents.

A Okay.

Q Producers receive, in negotiations with processors --

A Okay, I'm with you. A blend price plus a basis.

Q Or a Class III plus --

A A basis.

Q Plus a basis.

A Yeah, which we call premiums.

Q Which are called premiums. So Class III price,

producers price differential, plus premiums?
A Yes.
Q So it works somewhat the same way?
A Yes.
Q And there currently are, to a lesser extent today than four years ago, plants that make cheese that are in the Federal Order system that are located in the west?
A There are to a lesser extent now than there were. I don't know, John, possibly.

I'm not sure, you know, we recognize that there was an order that was voted out that it probably had some cheese plants associated with it. There's been some growth, you know, probably volume-wise you're probably right. I don't know what the population, if any, of the smaller cheese plants.

Q Well, there's still a Federal Order for the Pacific Northwest and still cheese produced in the Pacific Northwest?
A Correct.
Q The current minimum price upon which premiums are based reflects a NASS survey that includes, probably to an inadequate degree, but includes the basis, the negative basis in that case,

subtracted off the CME for western production?
A It includes it, yes.
Q And if the CME were used flat without an adjustment, the western plants would be put to an additional disadvantage of the difference between the current NASS survey price and the CME price?
A Historically, the CME price has been higher than the NASS announced price; so, yes, for the Pacific Northwest.

JUDGE PALMER: Any other questions? Yes, Mr. Rosenbaum.

RECROSS-EXAMINATION,

QUESTIONS BY MR. STEVEN J. ROSENBAUM:

Q With respect to the $0.20 mandatory assessment to pay for the milk pep program, Mr. Beshore has indicated correctly that processors who sell less than three million pounds a month are exempt from that requirement, correct?
A Yes.
Q Do you have any idea, collectively, what percentage of the total production that exemption represents?
A It's a minimum amount -- minimal.
Q Mr. Beshore asked you some questions regarding

whether -- let me back up.

You recall that in my earlier questioning I talked about a scenario in which a buyer would say, "Well, look, just rather than charge me $1.40 plus $0.3, that you'll list as a" --

A I remember the $1.37 plus.

Q $1.37 plus 3. I understand Mr. Beshore to ask you some questions as to whether such a mechanism would require the abandonment of CME plus basis pricing.

Do you recall him asking you that?

A Yep.

Q Let's assume that under the current arrangement between that manufacturer and that buyer, the contract provided for CME plus $0.4, to make up a number, okay?

A Okay.

Q Wouldn't one be able to achieve -- and let's assume that the hearing had established consistent with a hypothetical I've been using all day, that the increased make allowance -- increased cost of manufacture was $0.3 higher than the current make allowance, okay?

A Okay.

Q Wouldn't the contract simply have to provide that the price would be the CME plus the existing basis of $0.4 minus $0.3 to achieve the scenario I had laid out?
A Let me think about that for a second. That could occur.
Q Now, in terms of -- I think you used the term in response to someone else's question that an "equilibrium" has developed between cheese supply coming from the west, including California and Idaho, and cheese produced in the rest of the country, correct?
A For this moment in time.
Q It's a shift in equilibrium.
A Absolutely.
Q But there's some equilibrium.

And Mr. Beshore identified, and I don't know how representative this particular relationship is, but for the data he provided a $0.13 relationship between the price in Minnesota, Wisconsin and the all-other-states price, correct?
A For that particular month I think is representative -- or excuse me, that particular week; that particular week.

Q I'm sure he gave accurate information. I'm just saying -- I'm not suggesting that's typical or not typical.

But still, if we had a scenario where the cost of manufacture were up $0.3, that would represent a 23 percent increase over the -- let me put it this way: If the cost of manufacture were up $0.3, if California addressed that by dropping its make allowance and the federal system did not, then the $0.3 would represent, if you will, a 23 percent change in the price relationship between the California price and the federal price?

A You've calculated the numbers the way you want, I would say you can report those on brief.

I would use an example of more like a $0.006 change and make the calculation based on that. So we can send in our briefs and report however way we want to calculate it.

Q Well, I'm still using my hypothetical, and you would agree with me that I've laid out --

A I can't that quickly calculate the percentage. I'll take you on your word that you calculated it the right way.

MR. ROSENBAUM: That's all I have. Thanks.

JUDGE PALMER: Anything else? Thank you very much, sir.

MR. BESHORE: Have 53 and 54 been received?

JUDGE PALMER: No, let me receive 53 and 54 -- actually 53 was, but for the record they're both received.

MR. BESHORE: Thank you.

JUDGE PALMER: Probably a good time just to take the lunch. I don't know break and be back at 1:00.

During that period of time, give some thought who you want your next witness to be, who has to get out today. Hopefully we will get to Mr. Yale, hopefully complete him today or first thing tomorrow morning.

Break for lunch, we'll be back at 1:00.

(A recess was taken.)

DENNIS J. SCHAD,

having been duly sworn to tell the truth, the whole truth, and nothing but the truth relating to said matter was examined and testified as follows:

(Exhibit 55 was marked for identification.)

(Exhibit 56 was marked for identification.)

(Exhibit 57 was marked for identification.)

JUDGE PALMER: On the record. Mr. Schad is on the stand. We just marked for identification three documents. One is 55, and that relates to proposal 6. One is marked as 56, that relates to proposal 7 and 8, and one is marked as 57, that relates to proposal 15.

The court reporter has not met Mr. Schad before, so if he would be so kind as to give his full name and spell it for us, we'll be in great shape.

THE WITNESS: Dennis Schad, S-C-H-A-D, I work for Land O'Lakes and my business address is 410 Park Drive, Carlisle, Pennsylvania, C-A-R-L-I-S-L-E.

JUDGE PALMER: And I will turn it over to Mr. Vetne to do what Mr. Vetne does.

DIRECT EXAMINATION,

QUESTIONS BY MR. JOHN H. VETNE:

Q Mr. Schad, you have previously appeared on the witness stand and provided your curriculum vitae, experience, and so forth, in the record of this proceeding?

A That's correct.
Q And that was at the Strongsville segment of this proceeding?
A That's correct.
Q We won't do that again.

MR. VETNE: Your Honor, Mr. Schad has, as indicated, three statements which have three exhibit numbers, because frequently some of the questions, as well as some of the witness' testimony may interrelate. I would request the witness to read all three rather than read one, take questions on one, and so forth and so on.

JUDGE PALMER: Any objection? Anybody going to have any problems following along that way?

Doesn't appear to be any. Proceed that way.

Q Proceed, Mr. Schad. Thank you.
A Thank you very much. Again, I testified on the first day and I guess on the second day in Strongsville the introduction to Land O'Lakes and Land O'Lakes' impact into the Federal Orders is included in that testimony. I did not include it here.

JUDGE PALMER: You're incorporating that

testimony into this?

A Yes, I'm incorporating that testimony.

Land O'Lakes opposes proposal 6. Proponents to this proposal assert that an algebra mistake was made in the 2002 final decision that resulted in the undervaluing of butterfat. They state that the butterfat yield coefficient should have been 1.211 instead of the 1.2 factor. Additionally, this proposal would change the assumed butterfat recovery in cheddar cheese from 90 percent to 94 percent.

The language in the final decision (67 FR page 67921) is ambivalent concerning the correct calculation of the butterfat portion of the farm-to-plant loss?

A . In that decision, the Secretary wrote "The final decision incorporates an adjustment to the yield coefficients for each milk component. The adjustment is based on an overall factor of 0.025 percent loss of each milk component and an additional 0.015 pounds of butterfat lost between the farm and the receiving plant. (67 FR 67918).

From this passage it is unclear on which measurement or volume pounds of butterfat or

hundredweights of milk the additional butterfat loss should be calculated.

Later in the decision, the Secretary again addressed the issue in the butter yield section. He writes "Testimony and comments indicate that from the plant losses on all milk solids is .25 percent (0.0025) with butterfat incurring an additional loss 0.015 pounds per hundredweight of milk. (67 Federal Register 67920).

If the discussion stopped here, I would have to agree with the proponents' arithmetic; however, in the explanation of the calculation, the Secretary further wrote "In addition, for every pound of butterfat there is an additional 0.0150 farm-to-plant loss on butterfat solids (0.9975 minus 0.0150 equals 0.9825) pounds of butterfat." (Federal Register volume 67 page 67920).

Here the Secretary clearly states that the additional loss is related to butterfat volumes not hundredweights of milk. Quite frankly, it's unclear whether the additional butterfat loss related to a hundredweight of milk or on each pound of butterfat. It will have to be up to the Secretary to clear up that inconsistency in

the next decision.

However, before the Secretary rules on the yield question, Land O'Lakes believes he should consider butterfat price in its entirety. At the 2006 make allowance hearing the witness from the Rural Cooperative Business Service testified that there was an inadvertent error in the reporting of butter and powder cost at the May 2000 hearing. The RCBS cost survey on which the Department relied on to set butter and powder make allowances, included two plants that were located in California, that's known to testimony at that hearing January 24, 2006, page 124. This error resulted in two California plants being included in both the RCBS and the California cost surveys. The consequence of this double counting error was the understatement of the cost of manufacturing of butter. During the 2006 hearing, the Land O'Lakes' witness offered Exhibit 42 page D (at that hearing January 24th, 2006), which recalculated the butter make allowance using the corrected RCBS report (January 24th, 2006 hearing Exhibit 20). The result was that the make allowance for butter should have been

$0.1195 per pound of product. No one disputed this testimony at the hearing in the briefing process, or in the tentative final decision.

Using the average 2001 through 2006 NASS butter price $1.4044 as a constant, the following calculations illustrate the various costs per pound to butterfat. Number one, utilizing the 2001 make allowance and 1.20 yield, cost equals the average price of butter $1.4044 minus the 2002 published make allowance result of $0.115 times 1.2 equals $1.5473.

Number two, utilizing the corrected make allowance and a 1.20 yield. Cost equals the average price of butter minus $0.1195 times 1.2 equals $1.5419.

Using -- utilizing the temporary final decision, or tentative final decision make allowance in the 1.20 yield. Cost equals the average price of butter minus the tentative final decision make allowance of $0.1202 times 1.2 equals $1.5410.

And in the fourth case, utilizing the temporary final decision make allowance plus the proposed 1.211 yield. Cost equals the average cost of butter less $0.1202 times 1.211 gives

you a $1.5552 cost of butterfat per pound.

The 2006 final -- tentative final decision only restored the butter make allowance to the level that it should have been in 2001. However, adopting proposal 6 would raise the cost per pound of butterfat to a level that exceeds the 2001 cost. In its exception and comments to the temporary final decision, Land O'Lakes objected to the use of Cornell survey of four butter plants as a representative proxy for the cost of manufacturing butter. However, almost all here agree that the California manufacturing cost survey is a highly regarded and audited survey of plant manufacturing costs. Exhibit 10 from this hearing reports the weighted average cost of butter manufacture from 2000 through 2006 at California butter plants. CDFA reports that the cost of producing a pound of butter increased from $0.0957 in 2000 to $0.1408 per pound of butter in 2006. A 47 percent increase.

The effect of the adoption of proposal 6 would be to increase the price a plant pays for butterfat relative to 2006 -- I'm sorry, 2007 to 2000 in spite of the evidence of increase in

plant cost.

Additionally, Land O'Lakes opposes the changing of the section in proposal 6 that would change the cheese make allowance formula by changing the assumption of 90 percent fat retention in cheese.

Land O'Lakes operates a cheddar cheese plant in Kiel, Wisconsin. The plant receives producer milk. The plant's cheese formulation relies only on milk to produce cheddar cheese. Whey cream is not reintroduced into cheese-making process nor is nonfat dry milk or condensed skim. The plant was included in both the RCBS and Cornell surveys of plant costs.

Land O'Lakes' experience at Kiel does not support the change advocated by the proponents of this proposal 6. The 2002 final decision using Van Slyke formula to estimate the cheese yield from one hundredweight of standard farm milk contained in 3.5 butterfat -- I'm sorry, contained in 3.5 percent butterfat and 2.9915 percent protein. Assuming butterfat retention of 90 percent and Casein-to-true-protein ratio of 82.2 percent, the final decision estimates a yield of

9.6615 pounds of cheese from a hundredweight of milk at 38 percent moisture. That from our Federal Register 67 page 67929.

In recent year, the Land O'Lakes plant at Kiel experienced a yield of 10.21 pounds of cheese per hundredweight and an average moisture of 38.19 percent. Additionally, the average test of the milk at plant silos that year was 3.6598 and the butterfat was 3.0131 percent protein.

I say in a footnote that I'm going to use those numbers in a calculation into the final decision, Van Slyke formula, and I note that those numbers are plant numbers and not farm weights and test numbers, so that portion of the Van Slyke that corrected for farm-to-plant loss was not in the numbers that I will be giving from this point here.

Substituting the plant's actual butterfat protein and moisture into the final decision Van Slyke formula provides an estimated 10.16 percent cheese yield. The actual cheese at Kiel is closely approximated by the final decision Van Slyke formula.

Land O'Lakes' real world plant experience

validates the fat retention and Casein-to-protein assumptions contained in the final decision in the Class III formula.

Land O'Lakes recommends that the Secretary reject proposal 6.

Land O'Lakes opposes proposal 7 and 8. Proponents of proposal 7 say that it is as likely in the southwest for a farms weight and test to be higher when compared to the level determined by the plant as the inverse. While the average daily delivery of farmers in the southwest and Arizona Orders may be larger than a truckload, dairy farmers pooled on the other Federal Orders are far more likely to be combined and comingled on a milk truck so that a full load of milk is delivered to the dairy. During 2006, the average daily production for farmers pooled on the Federal Orders was 6,264 pounds per day, which means on average there were four dairy farmers on each load of milk delivered. In the largest orders, the Northeast and the Midwest, the average daily production is only about 4,500 pounds. In the Northeast it is not uncommon to have 10 or more producers comingled on a single load of milk.

Proponents state that dairy farmers pooled on the Florida, the Southwest, the Arizona, and the Pacific Northwest Orders produce on average greater than a truckload of milk every day. However, the average number of producers pooled on those orders totals fewer than 2,000 dairy farmers and represents less than four percent of all dairy farmers pooled on the Federal Orders during 2006. (Federal Order Statistics Annual Summary 2006, Tables 5 and 7). And I include those tables at the back of my testimony for this section.

Over time, the practice of selling comingled loads of milk has produced a specific set of sales norms. For instance, in the six Federal Orders in which Land O'Lakes pools milk, all sales are priced at farm weights and test. Even if a plant negotiated a plant weight and test sales agreement, there would be no way to specifically associate a farmer's weight and test when there are at least three other farmers on the load.

Additionally, the practice in the Northeast and Midwest is to take component tests on one sample of the producer's milk per week. The

weekly butterfat protein and other samples are averaged together to determine the farmer's monthly component test. The farmer's paid on those averages and buyers are billed on those averages. While farmer's fat test may, for example, vary as much as 4/10 percent between weekly samples, the milk plants that buy producer milks are billed based on the producer's average monthly component test. If a plant does not buy the milk of a dairy farmer every day of the month, it is extremely likely that the test of a producer on any one day varies from the monthly average component value that the plant is billed.

Taking a weight measure of a liquid product is also imprecise science. Milk truck drivers take site or stick measurements at the farm tank prior to agitating the milk for sampling. The measurement usually expressed in inches is checked with a chart and translated into an estimate of the bulk tank volume expressed in pounds. After the weighing and sampling procedures, the milk truck driver pumps the milk on the truck in a process that usually leaves a small portion of the milk on the floor of the

milk house. Additionally, milk solids are left on the sides of the bulk tank requiring a tank wash and sanitation before the next milking. Obviously, fewer milk solids are delivered to the plant than are recorded at the farm.

It is usually stipulated in Land O'Lakes and their customers that a 2,500th percent difference between farm and plant scale weights is normal and acceptable margin of shrinkage. Normally, the contracts call for an investigation when a particular load of milk exceeds one-half percent shrinkage.

Land O'Lakes owns and operates a modern butter and powder plant in Carlisle, Pennsylvania. When the plant -- while the plant received over a billion pounds of milk in 2006, it also received cream, skim condensed and fluid buttermilk products. Also, while its primary outputs were nonfat dry milk and butter, the plant also processed whole and buttermilk powders, bulk milk, cream and condensed milk and buttermilk products. The plant's cost accountants track all solids not fat and fat pounds brought into the plant and volumes of solids not fat and fat contained in the plant's

products leaving the plant.

Every truck into the plant must cross one of the plant scales before delivery and departure. While each milk truck is not sampled for components, each silo of milk is sampled and the test is recorded along the total milk volume contained in the silo, which is derived from scale truck weights. Each day at midnight a tally of the milk received for the day and all silo tests is compiled to develop a daily report of solids not fat and fat received. Deliveries of products other than milk are individually weighed and tested and their volumes and components are also added to the daily mass balance report.

During 2006, the Carlisle facility experienced a .343 percent shrinkage between farm weights and plant weights and a .511 percent shrinkage in butterfat.

Just as the Carlisle facility compares component values paid for -- I'm sorry, I'll start that again.

Just as Carlisle facility compares component values paid for against component values received, the plant also measures the

components in the manufacturing products. Fat and solids tests are made on each product processed and are tallied to determine plant losses.

During 2006, the Carlisle plant lost 1.8 percent (1.8 percent) of its butterfat and 2.6 percent of its solids not fat through plant loss.

One explanation for yield loss in dairy plants is the sanitation requirements of a modern dairy plant. The cleaning cycle for an evaporator and the lines to the dryers is four hours for every 20 hours of running time. The cleaning cycle for a butter churn and the accompanying cream and butter lines is 8 to 12 hours, which occurs every three to four days. The cleaning cycle for a dryer is 36 hours, and is required every month. The major component of every dairy plant -- a major component of every dairy plant is the wastewater treatment facility. Costing as much 10 to 15 percent of the total cost of a dairy plant, these waste treatment plants isolate dairy solids from plant's operations before they were discharged in waterways.

Land O'Lakes owns and operates a cheddar cheese facility in Kiel, Wisconsin. Farm-to-plant losses at Kiel are similar to the losses experienced at Carlisle.

The 2003 final decision recognized a reality farm-to-plant loss and added the yield coefficient of butterfat and cheese protein and nonfat dry milk and butter to reflect the fact that manufacturing plants pay for components at farm weights and tests and receive a lesser volume at the plant. Evidence from Land O'Lakes' manufacturing plants confirms that the solids not fat and fat losses between farm and plant, as well as the fact that amounts of fats and solids not fats are lost before they are processed into products. It continues to be wholly appropriate for shrinkage to be recognized in the product formulas.

Land O'Lakes opposes proposal 15. The dairy farmers of New Mexico propose that the CME, the Chicago Mercantile Exchange Price series be substituted for the NASS price series for the purpose of calculating the Class I mover and the Class II, III, and IV prices. This issue was fully discussed in the 2000 hearing

and the 2003 final decision ruled that the NASS survey was superior to the CME for purposes of starting class prices.

In their December 22nd, 2006 letter to AMS, the proponents state "price circularity in the NASS survey" as the rationale for forwarding this proposal. They correctly state, "they" being the proponents, correctly state -- let me strike all that and start with that sentence again.

They correctly state that the proponents of changing the make allowances at the 2006 hearings argued that manufacturers were unable to pass on increased costs to customers because all price increases were captured in the NASS survey and ultimately returned to dairy farmers through increased class prices.

The proponents failed to support the obvious solution to price circularity. A timely and fair updating of make allowance. Fixed make allowances guarantee that all commodity price increases are passed to the dairy farmers through increases in class prices. Failure in the system which guarantees the dairy farmer participation and commodity markets occur when

the Department fails to set unrealistic make allowances. Inability to pass on price increases by manufacturers to customers becomes a nonissue when make allowances are fairly and regularly set.

In 2003, the Secretary determined that the CME is a thinly-traded market and that NASS price survey better represents the weekly sales prices of commodities. The following chart is gleaned from summing the weekly NASS transactions between January 8th, 2005 and December 31st, 2005, and the total CME transactions for 2005 as reported on page 14 of Dairy Market Statistics, 2005 annual survey.

Do I need to read these?

JUDGE PALMER: No, it's there. Just go on to the part that you're reading. There's a chart in the statement and that will just be there. The reporter could copy it in, please.

THE REPORTER: Okay.

JUDGE PALMER: Thank you.

A Update evidence concerning the scope of current market transactions between the NASS and CMA surveys do not change the conclusions of the 2003 final decision. That's in Federal Registry 67 page 67912 -- I'm sorry Federal Register 67 page 67912.

Additionally, the final decision noted that had the NASS is a national price survey while the CME's is a geographically-defined market. Sales specifications required at CME butter transaction occur only in improved facilities located in Chicago and that cheese be transacted within 300 miles of Green Bay, Wisconsin and that nonfat dry milk sales be delivered to approved facilities within 300 miles of Chicago. Cheese and nonfat dry milk transactions may be executed at other approved facilities if a

freight allowance is paid, and that is in the specifications of the CME and the citation as listed here. Setting a Federal Order price based on a survey of national manufacturing production costs require that the commodity pricing series be national in scope.

JUDGE PALMER: Mr. Vetne.

A That's the end of my testimony.

MR. VETNE: Unless the witness has some further comments on his statement, he's available for cross.

JUDGE PALMER: I noticed I think a misreading. I think you said, the first time, 30 miles from Green Bay. I think you meant 300 miles there as well in your statement.

It should be 300 miles, both references?

A Yes, that's correct. The second page of Land O'Lakes opposes proposal 15, should be 300 miles in both references to the CME geographic pricing.

JUDGE PALMER: The reporter will report it as such. Fine, are there questions? Yes, Mr. Yale.

CROSS-EXAMINATION,

QUESTIONS BY MR. BENJAMIN F. YALE:

Q Good afternoon.

A Good afternoon, Ben.

Q Let's just start where you ended, and let's talk about the CME a minute.

There was -- there's been significant testimony regarding the fact that there is a lag between the NASS and the CME.

Is it Land O'Lakes' position that the lag between the NASS and the CME is not an issue that needs to be addressed?

A Land O'Lakes has not taken a position yet on Agri-Mark's testimony on their proposal, so I'm not sure I can answer that one yet.

Q Okay. You testified -- you've got several cheese plants that Land O'Lakes owns, right; there's more than one?

A Yes, we have two in the Federal Order system.

Q Right. And I think one of them that --

A I'm sorry, three in the Federal Order system.

Q Where are those located?

A As the testimony last time I was up here, cheddar plant in Kiel, Wisconsin; mozzarella plant in Denmark, Wisconsin; and a plant that

makes specialty cheeses in Melrose, Minnesota.
Q Right. And Kiel's the only one that makes the cheddar?
A That's correct.
Q So cheese is sold from that site to whoever buys the cheese, right?
A Cheese from that plant is sold to outside.
Q Okay.
A We make 40-pound blocks at that plant. We sell some of the cheese to outside vendors; we also keep cheese for internal use.
Q You answered the question better than I asked it; that's what I wanted to know.

So you do sell some of the cheese?

A Yes, sir.
Q In 40-pound blocks?
A Yes.
Q You've heard some testimony in the last couple days that says the cheese is priced at the time it's made, or at the vat, sometimes called a "vat price" or at the time of making.

Do you know anything about that?

A I don't have the knowledge to testify on how our cheese is sold out of Kiel. I will say one thing, probably a question you might have wanted

to ask, that our outside sales are reported on NASS for both the whey and the cheese at that plant.

Q Thank you. Now, Kiel's within that 300 miles of Madison, Wisconsin, right?

A I thought I said Green Bay.

Q Green Bay, I mean.

A Yes, I'm sure it is.

Q Yeah. And when you set the price for the cheese -- or when cheese is sold out of that plant, would one expect that to be sold at the same price as cheese produced in California?

A Again, as I testified, I don't know the cheese practices at that plant, but if the question is more generic --

Q It's more generic.

A -- more generic of the price of cheese, cheddar cheese in Wisconsin related to California, I would agree with you that you would expect a higher price for cheese sold in Wisconsin than it would in California; and I think that probably the NASS numbers would bear that out, as well.

Q Do you know whether any cheese produced in the state of California is pooled now on any of the

Federal Orders, any of the milk that goes into any of the cheese plants produced in California pooled on any of the Federal Orders?

A No Land O'Lakes milk.

Q Huh?

A No Land O'Lakes milk.

Q Congratulations. Are you aware, it had been a problem a number of years, but that's been taken care of, don't you believe, in the pool restriction?

A I don't know the answer to that. Maybe I'll ask you when you --

Q You make a statement that NASS is a national price.

Do you know any cheese plants that sell based upon the NASS price?

A No.

Q And I think you've heard the testimony, I want to ask whether you agree with it or not, that the NASS basically averages the basis of all the plants' transactions, all the transaction amounts throughout the country to the CME?

A That would be an illogical assumption, yes.

Q Now, on the first page of that, I guess it's page 11, the way this thing is printed out --

A We're still on 15, proposal 15?
Q Yes. I thought I'd go backwards. My mind was there.
A Okay.
Q You have this paragraph that starts "the proponents fail to support the obvious solution" about the price circularity. And you go to the second sentence. "Fixed make allowances guarantee that all commodity price increases are passed to the dairy farmers through increases in class prices."

What do you mean by that statement?

A I mean as it is set up since the Federal Order reform, that make allowances are fixed, so that a processor doesn't get any more than his make allowance for taking milk and turning it into a finished product; and that any time that there's an increase in commodity prices, I mean, it gets -- it would be -- to the extent they reflect it in the NASS, all of those dollars go back to the dairy farmers and none to the manufacturer.
Q But the other alternative is to have those make allowances and those increases come out of the marketplace rather than from the producers and

they can get the best of both worlds, right?

A That assumes that there is somehow buyers of the butter, powder and cheese are willing to increase their prices on some -- the prices that they buy their products for other than the normal reasons that folks increase prices based on supply/demand, substitute products, imports, all those things.

And, you know, as pointed out in prior testimony, that you increase the NASS price, that increase goes back to the farmer and not the plants because of the fixed make allowance.

Q Is it your belief that every dollar increase in the commodity prices with fixed make allowances goes to the producers; that the plants do not also participate in increased commodity prices?

A Yes; they do not -- let me back up. Let me withdraw my yes because I said something in an answer --

JUDGE PALMER: Think about that for a moment. We're going to take a short recess and then we'll be back.

(A recess was taken.)

JUDGE PALMER: Back on the record. You were considering an answer.

A Ben, could you ask your question again, please.
Q Sure, let me put it this way: With your statement on the fixed make allowances, and I'm not going to do the math, but let's say for the moment the cheese price is at $1.30 and using the formulas that we have and the make allowance, it produces a price to producers of, I don't know, let's just say $13, I'm just using this as an example.

If the cheese price increased to say $1.40, and using the same formula, it yielded a number obviously greater than $13, okay, where obviously the producers are going to get some more money because of the increase in commodity price; that's what you were saying, right? I mean, in part, that those increases go to the producers.

My question is: Does any of that increase from $1.30 to $1.40 also go to additional profits or income to the cheese plants under these formulas?
A In a previous answer I said that to the extent that changes in prices are reflected in the NASS survey.

I'll still stand by that, given that

stipulation.
Q So that --
A And just if that entire $0.10 went into the NASS price, the answer would be an unqualified yes.
Q Right. So what you're saying, then, is that the yields that are used accurately represent what plants are getting for the production of their cheese, so there's no additional yield? They don't yield additional product other than that implied in the formula?
A Whether they do or not, I don't think it's contingent on the price of cheese.
Q But you would agree that if a plant yields, say, an additional half a pound of cheese per hundred pounds of milk than what the Federal Order formula implies, that as the price of cheese goes up, it's going to get more on that extra half a pound of cheese, right?
A I think I would agree with that, yeah.
Q And we'll get to it in a minute in a little more detail, but on the issue of shrink that the Federal Order implies a certain amount of shrink, and if you have a plant that's experiencing less than that, then as the price goes up, it would gain a portion of that extra

price that it would not be passed on to the producers; is that right? Under the formula, forget any other market forces.

A Since a shrink is caught in the -- no is accounted for in the yield portion of the formula, I guess I would stand by the same answer I did before.

Q Now, you made this comment about the "thinly-traded market."

Do you watch the market at all, the cheese market, the CME, and compare it to the NASS or anything?

A Not to a great extent, sir, no.

Q Do you know whether Land O'Lakes buys or sells from time to time on the CME?

A From time to time I'm sure Land O'Lakes does every possible transaction.

Q You say Land O'Lakes is a seller of cheese and it came to a point that the buyers were telling them that it's going to pay $1.30, but the CME, the last bid, I guess, would be, would be $1.40.

Wouldn't Land O'Lakes want to go to the CME and sell there rather than to the buyer at that higher price?

A I'm not involved in the -- in those transactions

in that part of Land O'Lakes, so I can't respond to that.

Q The CME operates in the context of the rest of the cheese market, right?

A I don't see how I could disagree with that.

Q Okay. And there's ample evidence that establishes that the NASS -- I mean, would you disagree that the NASS' highly correlates to the CME after you account for the lag?

A I've seen evidence that says 95 percent, and I think it's used to say that the NASS validates the CME, I think that's it.

Q That brings up the question, then, does the NASS validate the CME, or does the CME reflect what's actually being sold in the value in the marketplace in its totality as opposed to just a few trades?

A I think I would rather say that the NASS follows the CME and we have the empirical evidence that shows that.

Q Let's go back. Let's talk about the shrink a second.

A Are we off 15?

Q Pardon?

A Are we off 15?

Q We're on to 55. Off of 15, back to proposal 6.
A Yes, sir.
Q How do we know -- let me back up.
Do you believe that establishing the formulas that the yield should reflect what is happening in the marketplace?
A I don't know that yields would have anything to do necessarily with the marketplace.
Q Well in the manufacturing?
A In the manufacturing environment, I would just as -- it should reflect something -- it should see what kind of weighted average yield is, as well as an average yield, just as I would have testified to, to manufacturing costs.
It's put somewhere and it's in the -- it's put in the formula and there is some validation for it.
Q Okay. You really led into the question I want to ask. Are you aware of any information out there that reflects today what the yield is through the industry for butter, for example, from farm milk?
A No.
Q And would you accept from the Department, if one plant or two or three plants came up and said,

"This is our costs, and they don't necessarily reflect your cost, but these are our costs." And the Department says, "Ah-ha, those are the costs, so, therefore, that's what we're going to make in the make allowances."

A I believe that the Department took the cost of four plants last time to make that decision.

Q That's why I didn't ask for four, I only mentioned three.

A Reflecting I believe 14 percent.

Q And you objected to that, didn't you, because it was such a small number, right?

A Yes.

Q And I appreciate the fact that you did bring the evidence. I mean, I love data to make -- and I think everybody needs to make these numbers work.

But without a broad understanding of what the data actually is out there for all the plants, we really cannot take one or two and say this represents all the plants for a yield in the same we can take one or two and say this represents all the manufacturing allowances, right?

A Like I said, the Department used formulas, Van

Slyke formulas as their template or their rationale for the yields that they have, and other widely accepted, if you say, you know, the 1.2 and butter is the same thing used out in California, for instance. I mean, I think that's where their starting point has to be.

But are you asking me whether the Department should look at, you know, evidence of differences in yields? Yes, I believe they should. And the Department has also said that they will not -- that in-plant losses are a function of plant management and not something endemic to the manufacture of a product. But I think that you also have to bring that stuff in as well.

It isn't just -- okay.

Q That's why you have to look really what comes in the silo and goes out the dock, right?

A I think you would need to do that to have an empirical yield.

Q Let's back up. I think you've agreed that we do not have the empirical data on the yields of anything close to the level of data that we have on the manufacturing allowances.

A Yes.

Q So, in its place, the only thing we have out there, then, are theoretical yields, right?
A You've seen testimony at this hearing from myself and foremost that shows --
Q Actual yields. Right, I understand that.
A Right.
Q But we have the theoretical yields, but we only have a few of the actual yields, and we don't know whether the one is off and the other's off because we don't have enough data; would you agree with that?

Well, you probably don't, because you think yours is right. I mean, back to my point is that without any empirical data, how does the Department decide what anecdotal evidence does it use to go off of the theoretical data?

A In the absence of -- the Department has to use what's in the record and -- has to use the data that's in the record.
Q Do you have any suggestion how the Department can pick and weigh the anecdotal evidence to apply to the theoretical data?
A In their rationale of the cost of dry and buttermilk they took. Someone's commented it cost $0.2 or $0.3 more back in 2000, and they

took that as data.

I mean, the Department has to use the numbers that are presented in the hearing record.

Q Right. But I guess that just raises the question, then, how do we know how accurate that data is and the Department just has to take whatever it gets, right?

A That's the rules.

Q Now, let's talk about the butterfat recovery. First off, I want to start with something you didn't really directly address, but you're familiar with the protein formula, right, the cheese-to-protein formula?

A Sure.

Q The real simple one. And in that, it has that .9 factor times the Class IV butterfat test; you're aware of that.

A Yes.

Q Do you know why that .9 is there?

A That's the assumption of 90 percent butterfat retention.

Q Right. Do you have a position whether or not that number should exactly match what is being used in the butterfat retention in the Van Slyke

formula; irrespective of how you get to the butterfat retention, do you have a position whether that should differ or not?

A You've come up to the limitations of my expertise. I don't have an answer on that.

Q Okay. Now, you provided some vat yields, vat tests, as I understand, or silo tests, I guess they really are, and then also indicated some yields.

A Yes, we're talking on --

Q On the bottom of page --

A Proposal 6.

Q Right, the last full page and the second.

I was uncertain as to what's the difference between the 10.21 and the 10.16?

A I'm just saying that the 10.21 was the actual yield per hundredweight, and if I plugged the moisture, the butterfat and the protein into the Van Slyke formula that was used in the final decision, I would have come up with a number of 10.16 yield.

And I'm saying that the -- in the case of Land O'Lakes at its plant in Kiel, that the final decision Van Slyke closely approximated the actual yields at our plant.

And for a question that just -- if you went back to the final decision in the Van Slyke, in that portion of it, which is referred here in pages -- Federal Register page 67929, in that portion of it, when you're trying to get to the 9.6615 pounds that is in that portion of the final decision, that's also a function of the farm-to-plant yield losses.

Because these are plant numbers, I didn't put that -- those portions of the computations that are in the final decision in these numbers. And just for -- if people are checking my arithmetic, if you did the Van Slyke formula based on the 3-5 milk and the 299 protein, and did not put the fat to -- I'm sorry, the farm-to-plant losses instead of the 9.6615 pounds per hundredweight, you would come up with a 9.6852.

Just so the record's clear.

Q And you're saying that you use this formula at a 90 percent butterfat recovery in Van Slyke to arrive at these yields with those butterfats?

A Yes. I'm saying I used the final decision Van Slyke formula that is referred to at that page, okay. Plugged in our moisture, our protein, and

our butterfat, okay. And I came up with the number of 10.16 as the estimated yield from a hundredweight of milk at those components. And I'm saying that their actual yield was 10.21.

Q And, of course, that could be done by math. I mean, I'm not going to go through the math exercise.

A Sure.

Q And if it showed a higher or lower butterfat recovery than the 90, then that's what it shows, right?

A Well, if you solve just for the butterfat, you would come up with a number that was -- of course, you've got two things there that you're claiming are variable, the protein -- Casein to protein or fat retention. If you held one of these constant and one to the other, you would come to a number something less than 91 percent in order to get the exact 10.21.

Q Okay. Well, I want to now move on to the butterfat shrink -- well, the farm-to-plant shrink.

A And that's --

Q That's your --

A 56?

Q Yeah.
A Okay.
Q In your testimony you indicate that your producers are tested once a week.

I would also assume those are probably what, every-other-day pickups?

A On the most part, yes.
Q So this would be every third or fourth load of milk for a farm that would be tested?
A Every time the truck goes into the farm, there's a sample taken.
Q Right.
A Those samples are collected at the plant of receipt. All of those samples go into our lab and the lab chooses for each dairy farmer one of those samples on a seven-day period in which to test for components.
Q Which neither the hauler nor the producer is to know which one it's going to be, right?
A That would be the best way to do things.
Q Okay. I think what you suggested in your testimony is, is that because of the variability from day-to-day, and the same farm, that that in itself is going to create a spread between what was actually delivered and what gets tested; is

that right?
A Yes, sir.
Q And is the decision not to test every one of those samples an economic decision made by Land O'Lakes?
A We do what's required and anything that is above a requirement would be an added expense to our dairy farmers.
Q Okay. So it's a business decision in the same way that some may have decided to test for every load that goes out because they don't have to, they decided the cost is worth that effort; is that correct?
A Since it is not required, we don't do tests for economic reasons, correct.
Q Have you ever quantified how much the shrink would differ if you did every load test as opposed to your once-a-week sampling testing?
A Not to my knowledge.
Q Okay. And I noticed on page -- the second page that you indicate that you have contracted a 25 percent difference and have given it a range that if it got to twice that, then it would require some kind of effort between the parties to find out what the problem is?

A Yes.
Q Okay. But you've contracted that, right? I mean, it's a contracted percentage, right?
A It's stipulated in contracts.
Q At the time you stipulated it, you set a price for all of your milk, right? I mean, for the milk that was going to be delivered; some kind of -- might be class plus something, but you set a price or negotiated a price for the milk?
A I think so, yeah. Not a fixed price, but a priced based on reference points.
Q A reference price.
A Yes.
Q So if there's a difference in the class -- or if there's -- let me back up.

Most of these people you deal with on your sales of your milk have been around a long time, right? I mean, there's no new -- really new buyers; is that a fair statement?
A Are we talking about individuals or are we talking about --
Q Companies that are buying the milk. Is it fairly stable?
A I think that's correct.
Q So they're going to know the kind of milk that's

coming in because they've bought it from you before; they're going to know what kind of shrink, what kind of quality, how often the hauler's on time or late, all of that, right?

A I'll stipulate to that.

Q And that all enters into the negotiated price?

A Quality for sure. Timing of delivery, something you work out between the buyer and seller.

And there was a third criteria?

Q The shrink.

A Shrink.

Q The amount of milk compared to what they're getting billed for.

A I guess I would go back, most of our buyers are day-to-day, year-to-year buyers. So, yes, they would have knowledge of all of those things.

Q And on the second page it appears that the greatest amount of your loss comes from the -- at your Carlisle plant was in-plant losses as opposed to farm-to-plant shrink; is that correct?

A Yes, greater percentage.

MR. YALE: I don't have any other questions?

JUDGE PALMER: Any other questions?

Mr. Beshore.

CROSS-EXAMINATION,

QUESTIONS BY MR. MARVIN BESHORE:

Q Good afternoon, Dennis.

A Good afternoon, Marvin.

Q I think I -- I think you said with respect to response for one of Daniel's questions that just as the Department has looked at weighted average plant cost of manufacturing allowances, that would be a good way to go with respect to yields if the data were available?

A I think that's one thing they could look at. Also, there are theoretical yields. There is a body of work in dairy chemistry that you can't completely ignore. So you have to take that into effect; and I think the fact that some folks are bringing empirical evidence here to a hearing record. The Secretary should also look at that, too. I mean, I'm --

Q Would you agree that in general concept, the two -- those two areas should be viewed with equal levels of inquiry because they're part of the total milk price equation?

A I would think that the sense that you've got a body of work in dairy chemistry that already

estimates what happens in a cheese vat, and things like that, that the level of scrutiny there, the expectation of changes from those expected returns, if you will, or expected yields would be less than the changes in costs, which would be more contemporaneous with what's going on in business.

I'm not saying that the Secretary shouldn't look at empirical evidence, but I'm saying that the weight doesn't have to be as high as it would be on the cost side of it.

Q Well, to the extent that there is any, you know, just theoretical data to use, for instance, with cheese yields, that's analogous to a reference price; and what we're really talking about, when we talk about adjusting those yields for various factors, is the basis side of the equation.

Would you agree with that?

A Explain that. Try that one more time.

Q I was going back to the colloquy I had with Ed Gallagher this morning about pricing being a combination of reference price, CME, plus a basis, a difference, an add-on.

A Okay.

Q I think you're saying that in some product yield

equations, you start with a reference point, which is a theoretical chemical equation, correct?

A Yes.

Q But what we're talking about, nobody is debating that, per se, if there is one. What we're talking about is the basis or the change from that in terms of yields?

A If there is anything different than the chemical expectation of yield, then, yes; you've just defined it as basis, which would be the change from that expected yield -- from that expected theoretical yield.

Q With respect to losses, farm-to-plant or in-plant, there's no expected theoretical formula to fall back on, correct?

A Not that I'm aware of.

Q So we've got to rely on empirical data for those things?

A I would think.

Q And when you have data, such as you've provided with respect to both the Carlisle butter powder plant and the Kiel Wisconsin cheddar cheese plant, you have provided certain data with respect to the composition or the volumes in

composition of milk going into the plant, correct?

A Yes.

Q And the volume and compositions of the products coming out of the plant, correct?

A Yes.

Q Now, when you have that kind of data beginning volumes and end volumes, everything in between is factored into the equation; would you agree with that?

A Yes.

Q So looking at the -- well, let me just go to the Carlisle, which exhibit is that on? 56.

A Yes.

Q The receipts at Carlisle, the second page of 56 you say "Over a billion pounds of milk in 2006 -- "the plant received over a billion pounds of milk in 2006 and also received cream, skim condensed and fluid buttermilk products."

A Yes.

Q Is the billion pounds farm milk?

A Yes.

Q Can you give us any idea of the volume of cream that was received?

A No; I don't have those numbers with me.

Q Okay. Just for -- can you give us any anecdotal data at all; how many tankers of cream a day or a week might come in?
A I don't have that number with me.
Q Do you have any -- can you give us any idea of what portion of the butterfat used at the plant is acquired from the farm versus acquired in other products?
A I don't have that number with me.
Q A tanker of cream is roughly 40 percent butterfat?
A You would expect 20,000 pounds. 40 -- 50,000 pounds of cream times .4.
Q Okay. So every tanker of cream has butterfat from at least 11 or about maybe 11 average farms if you have 3-6 percent?
A I think. That's the expected norm.
Q Eleven to one concentration?
A I've heard 10 to 1, but I'll accept 11.
Q Okay. When you looked at -- well, it's fair to say you don't have the volumes. But your butter plant's a substantial purchaser of cream; is it not?
A It varies from year to year. 2006? I'm not sure -- and it varies seasonably, of course.

Compared to what?

Q Compared to -- I don't know, any other plant in Pennsylvania that buys cream.

A We have ice cream plants in Pennsylvania that I would expect buy more cream than Carlisle; yes, definitely.

Q Can you give us an idea what the annual butter production is out at Carlisle?

A I don't have that number with me.

Q Okay. In any event, the shrinkage that you report at the top of the third page of 56 --

A This is farm-to-plant shrink.

Q I'm looking at "During 2006 the Carlisle facility experienced 0.343 between farm weights and plant weights and 0.511 shrinkage in butterfat."

Is that farm? How is that compiled?

A That's farm-to-plant.

Q Farm tests versus?

A Versus scale weights at the plant and silo test, silo fat test.

Q Now, going down two paragraphs "During 2006 Carlisle lost 1.8 percent of its butterfat and 2.6 percent of its SNF through plant loss."

What are the comparisons there?

A And that would be that same weights of product going into the plant over the scales; they're just collected in the silos. The expectation goes across the scales, gets in the silos, and the tests are component tests of the silos.

We don't test every truck for components that come into the plant, we test at the silos; and we don't weigh -- we don't have an accurate weighing at the silos, so we use the scale weights for the volume.

The volume in the silos is a function of the scale weights and the component test is a component test of the silos.

Q Okay. But how are you --

A And that's --

Q You're comparing that to the fat and solids in the products you produce, then, I take it?

A And all the products that we produce. We account for the butterfat and nonfat dry milk butterfat, and butter butterfat and buttermilk powder, cream sales, bulk milk sales.

All of those end products are tested so when you go in and compare components at this point in the game and components out that side.

Q Components in and components out?

A Yes, sir.
Q I guess what I'm -- my question, then, is: Since your components involve nonfarm milk components, such as cream 10 to 1 or 11 to 1 concentration of butterfat in other components, how do you relate those -- how would you propose to relate those losses to the, you know, the farm milk conversion equations?
A To farm milk? They are two different things. At the top of that page, that's the farm side of it.
Q Right, I understand. I'm talking about the plant side. I'm talking about the plant side now, okay.

I'm off the farm-to-plant.

A You can't, unless you have a plant that completely runs milk for you and probably has empty silos on the 31st of December and empty silos on the following 31st, you can't.

You're trying to catch up with, in some cases, an elephant that's running very quickly.

Q Okay. I think I understand the data and I think we're at the same point. Whereas with Kiel, you had farm milk and cheese product out?
A Yes, sir.

Q And you could relate the two directly?
A Yes, sir.
Q Your data for Carlisle is silo components in, which is farm milk, cream, condensed, buttermilk, okay, and other products out; and there's no way to relate that to farm milk equation?
A Yes. Relate that exclusively to farm milk, yes. And I'm sure I could have accountants here who'd do gymnastic allocations for you.
Q Well, without volumes, we can't even do any allocations really, right?
A No, you can't.

MR. BESHORE: That's all the questions I have right now. Thanks.

JUDGE PALMER: Are we complete? Anything else for the witness?

Mr. Vetne you have a question.

REDIRECT EXAMINATION,

QUESTIONS BY MR. JOHN H. VETNE:

Q Just apologize, I neglected perhaps.

Mr. Schad, one of your -- you testified about your cheese and cheese byproducts.

Did you talk about your disposition and sale pricing of whey?

A Yes, at our Kiel plant, as I testified, we don't put whey cream back into the vats and we sell our whey cream probably an average of seven every two weeks, I guess -- about seven a month. Almost two loads a week -- less than two loads a week of whey cream. It's at a contracted price and my -- the pricing that we have FOB plant is very comparable to the pricing that was testified to as by foremost, as well as the gentleman from Iowa, Twin County Cheese.

Q So that fat is sold in whey cream at a discount compared to fat in sweet cream?

A That's correct.

MR. VETNE: That's all.

JUDGE PALMER: I think you're finished, sir. Is there anything -- I'm sorry, Mr. Schaefer.

CROSS-EXAMINATION,

QUESTIONS BY MR. HENRY SCHAEFER:

Q Good afternoon, Dennis.

A Good afternoon, Henry; how are you doing.

Q On your Exhibit 56, you talk about the 6 Federal Orders that Land O'Lakes pools work on "all sales are at farm weights and test."

Are you referring only to your sales or to

the entire Order?

A I am referring to Land O'Lakes' experience in those Federal Orders.

Q And would the same be true with the once-a-week sampling -- or once-a-week testing of components that is on the LOL, or maybe other handlers who test every load or do something else?

A It would be my experience in the Northeast Federal Order that this is the way it's done and it's also my belief that it's done the same way in the Upper Midwest.

Q For all handlers?

A Yes. The normal -- in terms of trades in both of those cases, you've got normally the loads are comingled so that you have more producers on than one -- you have more than one producer per load.

Q But if you were pricking up individual -- you had more producers on one load and you're picking a sample off each time you pick the producer up, you would have individual samples for the producers and could test every load?

A You could test every load, but it's my understanding it's not done that way.

Q Okay. When you have your contractual obligation

and you've got this 2500th of a percent, I don't know whether allowable shrink is the right term, but you have a normally you're working with in there. If you settle -- when you settle, are you paying your producers, then, on the same thing that you're settling with the handle or are you paying your producers strictly on farm weights and test and settling on some other value, then, with the handler that you sold that milk to?

A No, on both the weight and the test, we bill the handler the same as we pay the producer. That part of the business we want to complete wash, so that if our members, you know, by their farm weights made a million pounds, we would be billing a million pounds out; and the same thing with the components.

MR. SCHAEFER: Okay. Thank you, Dennis.

A Thank you.

JUDGE PALMER: Thank you very much, sir. And we'll recess now again.

Mr. Yale, you'll take the stand and make yourself comfortable up there and we'll be back in about five minutes or so.

(A recess was taken.)

JUDGE PALMER: He's still under oath.

BENJAMIN F. YALE,

having been previously sworn, testified as follows:

DIRECT EXAMINATION,

QUESTIONS BY MR. RYAN K. MILTNER:

MR. MILTNER: Ryan Miltner with Yale Law Office.

JUDGE PALMER: Mr. Yale, is back on the stand now for examination. A couple days back he completed his direct testimony, although I imagine there will be maybe a little extra now today, I don't know.

But you also have handed me some exhibits that we need to -- they're corrections of exhibits we already received, and let's just see if we can get them marked in a way that everybody knows what we're dealing with.

Which one do you want me to look at first?

Q The first one, Your Honor, is a spreadsheet landscape, this way, at the bottom it's marked "VVV" and that's a supplement to Exhibit 33, so if we can mark that, I suppose, 33A.

(Exhibit 33A-VVV was marked for identification.)

JUDGE PALMER: We'll make it 33A VVV. You

have all the numbers.

MR. MILTNER: I have no preference.

JUDGE PALMER: VVV.

MR. MILTNER: It looks the same?

JUDGE PALMER: So that will be 33A-VVV. And then the next one, they look alike, these next two.

MR. MILTNER: There should be three, Your Honor. They're each three pages.

JUDGE PALMER: Which one do you want to take first?

MR. MILTNER: The first is headed "Cheese Process Flow, No Fortification, No Whey."

JUDGE PALMER: No whey. No fortification, no whey.

(Exhibit 34A was marked for identification.)

MR. MILTNER: And that's 34A, I would suppose.

34B would be headed "Cheese Process Flow, Fortification, No Whey."

(Exhibit 34B was marked for identification.)

MR. MILTNER: And then 34C is headed "Cheese Process Flow, Fortification, Whey."

(Exhibit 34C was marked for identification.)

JUDGE PALMER: Fine. They're so marked and the reporter has those. Very well.

MR. ROSENBAUM: Your Honor, these are four separate documents? I only have two.

JUDGE PALMER: I forgot her name, but Mr. Yale's other associate will be there with you in a moment.

MR. MILTNER: There are four separate documents and Christine Reed is handing those out.

JUDGE PALMER: Do you wish to add anything to the direct testimony at this point?

MR. MILTNER: Well, I do want to have Mr. Yale explain these.

JUDGE PALMER: These documents?

MR. MILTNER: And then there are a couple small points and we'll go ahead.

JUDGE PALMER: Let's make sure everybody has their copy.

MR. MILTNER: Sure.

JUDGE PALMER: Mr. Rosenbaum, do you have them all and all properly marked now?

MR. ROSENBAUM: Not yet.

JUDGE PALMER: Does everybody over there have the copies and know the markings? Anybody confused? You're confused? Well, she'll be back in a minute.

Ms. Reed, could you give some to counsel up here at the front table.

MS. REED: They already have.

MR. MILTNER: And I'll give the titles again. 34A "Cheese Process Flow, No Fortification, No Whey."

34B is "Cheese Process Flow, No Fortification" -- I'm sorry, "Fortification, No Whey."

34C is titled "Cheese Process Flow, Fortification, Whey."

JUDGE PALMER: Everybody clear? All right so go ahead.

Well, I guess we won't go ahead. Off the record for a second.

(A discussion was held off the record.)

JUDGE PALMER: Let's go back on the record.

Q Mr. Yale, Ben, could you look at page 43 of your statement, if you have that in front of you. That's Exhibit 32.

A Okay.

Q Now, also turn to what is document VVV in the bound Exhibit 33.

A Okay.

Q Okay. Do you have both of those?

A I have those in front of me.

Q If you could look at your statement and at the top of the page it describes what document VVV relates, and if you look at document VVV in the bound volume, they don't appear to match up.

A Right. The explanation is, is that what's been marked as 33A, I guess 33A-VVV, is another one of those worksheets that I did using the format found at KK, document KK, and it only applies to changes to the fat-to-true-protein ratio as described at the top of my prepared testimony at page 43.

What we have is, the mistake was in putting all of this together, is that UUU was a preliminary and could also be used as the same thing as VVV that's in the book. And when they were putting it together, they thought they were two different documents and that's how that got lost. But UUU and VVV that's in the book really are really the same exhibit, and then this would replace the VVV that's in the book.

Q Okay. Now, another kind of housekeeping matter, you read your 50-page statement and there were times when what you read was not what was written, and I'm not -- don't intend to go through each of those, but I want to make it clear that where there is a discrepancy between what is in your written statement and what was stated, you want the written statement to control?

A At this moment, I'm not aware of anything that I said that was different than the statement that should override what was in the prepared statement.

Q Except for you made a few side comments, which are obvious. But if there's a number or a factor that differs, the written statement contains --

A The written statement would cover it.

Q Okay. And for the sake of speed, when you read formulas in the statement, you omitted parenthesis and some punctuation.

A Right.

Q But as in the written statement, that punctuation is rather important to things like order of operations and whatnot, so, of course,

the transcript, when it includes your statement from the stand as you read it, you're going to have to refer to Exhibit 32 to understand what the formula actually states, correct?

A That's correct. The decimal points and the parentheses and all the other symbols in there are absolutely critical both in their existence and their placement.

Q Okay. Now, you discussed on Monday a mass balance spreadsheet report model that you have it was marked as Exhibit 34.

A That's right.

Q And I don't know if because of the time we had a chance to explain what your purpose for introducing that document was; and could you explain for the Department what you wanted to describe with Exhibit 34?

A The purpose -- the primary purpose of Exhibit 34 is to outline a methodology that requires us to look at, particularly in the case of cheese in a plant, look at the totality of how the milk comes in and it comes out in a product as opposed to getting lost in the minutia. In other words, I wanted to map out the forest so that we don't get lost as we look from tree to

tree on some of the individual details of some fairly complex formulas.

It's also to -- one of our views -- we've really got two things that all of these exhibits and the testimony really can be boiled down to, one of which is that we want to use a pinpoint of the average in the market for setting these numbers where we have choices. We need to have a consistency there. But the second one is, is that as we look at these formulas, we need to look at, in a sense, milk coming into the silos, product going out on the dock, as opposed to little bits and pieces.

So the idea of this was to create a methodology that forced us to look at the whole thing, and then to see also, to exhibit and show into the record how multiple choices plants can have a real impact on the amount of butterfat recovery and yields that they get out of the product for purposes of discussion.

It is not to say that this is exactly how a plant operates, any plant. The numbers work, but its not to support the idea of the numbers, but how the numbers would flow given the input that we put in here, this is the result that you

could get.

Q And the methodology that you described, I believe when you testified on Monday, is, is the kind of methodology that people who are making decisions about constructing a manufacturing plant, particularly cheese plant, would engage in this kind of analysis?

A I think not only construction, I think day-to-day operations. As I recall, Mr. Schad testified, I didn't ask him the details, but they had a mass balance that they looked at all their product coming in and tried to analyze it. I think any well-run plant today is going to do that type of analysis similar to this to track actual as opposed to theoretical values; maybe compare them to theoreticals so they can identify problems. It's a commonly used methodology there.

It is also important to use it to make sure that you test that your individual choices that you make on individual parts of the formula that somehow or another that they all are part of this larger context and make sure that they don't get out of context, so it forces that. It's all of those uses. It's in use in the

construction. It's in use in running the plant. It's in use in testing the formulas and to provide a guidance to the Department in how this system works.

Q You mentioned that there would be individual choices that would be made throughout that process.

What are some of those individual choices that appear in your exhibit that they can be considered?

A Well, the first choice that was made in this one, just to simplify it was, it's a cheddar. You know, a mozzarella and Italian style cheese flow would be different in some significant ways. But the choices, you know, how much milk are you going to run through it, there's decisions in terms of how you're going -- whether you're going to standardize to the fat, standardize to the protein, are you going to use fortification, are you going to use whey, not use whey. If you're going to fortify, how are you going to fortify? Are you going to use ultrafiltration or are you going to use nonfat dry milk, are you going to use condensed.

I mean, there's just all of those choices

and they vary even within a given plant almost from batch to batch. But this is just a theoretical flow. Those are among the many decisions that can be made.

It was really part of an optimization model that sometimes people would use, this one simply -- those are the major choices that I -- and I exhibit those, by the way.

Q Now, if you could look at what we've marked as 34A, 34B, and 34C.

A Yes.

Q Without getting into details at the moment. Can you tell us what each of those documents conveys?

A Well, let's talk in general about what the labels are. After basically some conversations after the testimony, I decided to try to respond to part of it was to look at three different possibilities; one of which is you just take the milk that comes in the plant and depending on whether your milk or protein -- fat or protein deficit, it would pick the best choice that would produce the cheese, how did that work? That's just simple milk coming in.

The second one is, is that there's some

fortification that goes in, which is basically we're going to standardize to the fat that comes in; and that's the "Fortification, No Whey," 34B.

And then the third one is to look at what the reincorporation of some of the whey could have as an impact in terms of what's going on in the plant. Otherwise, they all are the same model.

Now, having said that, first of all we talked about input. I have tried to, and I may have missed it, but consistent with what I did in the KK series of documents in my Exhibit, I think it's 34, I put in bold and italics those inputs that I put in. The rest of it is basically mathematical operations on factors within the spreadsheet.

And the only exception -- everything that was used -- there might be a few factors that might be buried in there, but by and large, everything that's in these formulas you see. And the only exception is, is that the one that uses the whey, you will notice -- and that's 34C, that where it says "whey cream" and in this case I used 50 percent, it's just a number, it's

even a different font to show that that's some numbers that came from a shadow operation of the plant that produced whey basically on the same contents and same assumptions that we have here to provide the whey.

The rest of it, somewhat I tried to make it appear to be fairly logical in the way it flows. I'm sure there's a few difficult issues, but basically it flows the way it shows.

Q So 34C includes the incorporation of whey cream from a previous process?

A Right. But it's identical to this one, other than the incorporation of whey.

Q It appears that the model allows you to change assumptions about the inputs?

A Yes.

Q Such as the butterfat and protein content; all the component elements of the inputs; is that correct?

A That's right.

Q And it allows you to decide how much milk to ultrafiltrate if you chose to do so?

A Yes, and the concentration at which the ultrafiltration would occur.

Q What about the butterfat recovery rate?

A That is also an input. In this case, I assumed 94 percent, which is a number that we've been using.

I left the protein Casein at what the Department's been using, not because I necessarily agree or disagree, I decided only to change the one.

Q You can also adjust the moisture content?

A The moisture does vary both in terms of what the customers want and what you actually produce, from what I understand.

Q Finally, with regard to Exhibit 33, except where you've noted in your testimony, are all of the documents in that exhibit publicly available, and with the exception of the Scherping proposal?

A I believe that that -- yeah, the Scherping proposal is the only document that was obtained outside of the public, either through the Internet or government documents, unless it's clearly one of the spreadsheets that I prepared and I identified that I, in fact, had prepared them.

MR. MILTNER: Your Honor, subject to the restrictions that we went over on Monday, we

would like to move the admission of all Mr. Yale's exhibits.

A Well, we were going to withdraw 34, were we not, as it is because of the error.

JUDGE PALMER: Well, we have Exhibit 33, which was the original testimony statement.

MR. MILTNER: 32?

JUDGE PALMER: Is it 32?

MR. MILTNER: Yes.

JUDGE PALMER: You're right; 32 and 33 -- which are you moving for, all of them?

MR. MILTNER: Yeah.

JUDGE PALMER: 32, 33, 34, plus these changes 33A, 34A, 34B, and 34C.

Mr. Rosenbaum is rising to his feet.

MR. ROSENBAUM: Substantial discourse that Mr. Beckman was involved in on Monday regarding one of the exhibits.

MR. MILTNER: And I said "subject to that objection."

MR. ROSENBAUM: I just want to make it clear. I don't understand counsel here to be trying to read it at that side.

Let's limit the use of a particular one of the documents contained in Exhibit 33.

MR. MILTNER: I think it was document SSS?

MR. ROSENBAUM: I don't understand him to be asking you to revisit that. I want to make that clear. I want to be clear.

MR. MILTNER: We're not. And I think the limitation was that it was admissible for evidence of his existence, but not the accuracy of its content.

JUDGE PALMER: Fine. We'll receive it subject to that restriction.

Q Mr. Yale, you brought up that Exhibit 34, which was marked, there was a discrepancy in some of the numbers.

A It was the wrong exhibit.

Q But the model is the same model?

A Yes.

Q That you used to create 34A, B, and C?

A That is correct. Just that the one that we printed was the wrong one, so this corrects and replaces those.

Q And the methodology is identical?

A Basically is identical.

MR. MILTNER: He's available for cross-examination?

MR. ROSENBAUM: I heard someone use the

words "withdraw Exhibit 34." I think you mean --

A It's replaced.

MR. ROSENBAUM: It's replaced. But it will stay, because I think all my questions were about Exhibit 34. I don't want to do them all again if I can avoid it.

JUDGE PALMER: We're not actually withdrawing anything. We had it as an extra exhibit, gave it a number. Even though he doesn't want you to consider that, but it's in there.

MR. ROSENBAUM: Okay.

JUDGE PALMER: Okay.

CROSS-EXAMINATION,

QUESTIONS BY MR. STEVEN J. ROSENBAUM:

Q Steve Rosenbaum for the International Dairy Foods Association.

Mr. Yale, your written testimony, Exhibit 32.

A Okay.

Q You devote some significant attention to a comparison of what you say the prices were under the tentative decision as announced at the end of 2000 versus the prices in effect based upon the formula that is now in place, correct?

A Well, I did discuss it fully, I believe, yes.
Q And looking at page 13 of Exhibit 32, your written testimony, you have a paragraph that begins with the words "what the spreadsheet tells us"?
A Yes.
Q And this is your effort to calculate, to capture, what you say the difference is between what the prices would have been for the calendar year 2006 had the tentative final decision, as announced in 2000, been in place versus what the prices would be with respect to the year 2006 under the formulas now in place, correct?
A The purpose of KK was twofold. The primary purpose was to use that comparison that you just mentioned as a basis to explain what I am going to use as a baseline computation for the rest of the documents, which means using the current formulas and comparing them to something else. And as a basis, so that without getting into argument over the rest of the testimony, I chose what I recalled to be the formulas in 2000 -- effective in 2000 that were then changed in -- wait a minute.

Yeah, they were effective the first of

2001, and then were changed in, I think, March of 2003.

Q So you're comparing -- you're trying to capture the effect of the formulas as they existed as of January 1, 2001 versus the formulas as they existed March 1, 2007, correct?

A That was the secondary purpose of the exhibit, yes.

Q Well, you specifically provided in this paragraph a statement as to what the effect of the shift from the January 1, 2001 formula to the March 1, 2007 formula has been in terms of the butterfat price, the protein price, et cetera, correct?

A That's right. Using the model or the spreadsheet in KKK --

Q KK you mean?

A I mean KK, applying the numbers that were in the assumption in JJ, derive the numbers that were there, and those are the ones that I quoted in my testimony.

Q And you ultimately conclude that you believe that producer blend prices had been reduced an average of $0.56 per hundredweight based upon the changes in the formula between the

January 1, 2001 formula and the March 1, 2007 formula, correct?

A My conclusion is that taking the average NASS data for 2006 and the order utilization in pounds in 2006, and applying two different formulas, one, the formulas that became effective March of this year, and one the formulas as I recalled the ones available in January of 2001, using the same input, I ran both of those side by side to show what the changes were and the changes were those that are reflected in KK and restated, I believe, in my testimony at page 13.

Q And I'm correctly understanding that following the methodology you just described, you conclude that producer blend prices have been reduced by an average of $0.56 per hundredweight?

A Assuming nothing else changed, nothing, including prices and pounds of milk produced, the number of producers, that was the number that I computed.

Q And you were trying to -- by eliminating any of those other changes, you were trying to isolate the impact of the changes in the formulas?

A That was the hope, yes.

Q And you then returned to this theme again on page 50 of your testimony, where you make a comparison between what you say the effect has been of the change in formulas from January 1, 2001, to the present, versus what the impact would be of your proposals, correct?
A Yeah, using the same baseline, the same inputs, isolating all other changes, the multitude of changes that can impact blend trying to isolate, that is what we did with that exhibit, and I can't remember which one that is, GGG.
Q EEE, I think. If you look at page 50, it's EEEE?
A Quad E.
Q By the way, I noticed there on page 50 you talk about "the formulas having producer blend prices by $0.57." I assume that's just a rounding or maybe even a typo?
A It may have been that when we were looking at it, when you are dealing with these numbers, it can move a penny one way or the other.
Q Now, your statement as to the impact of the changes between the January 1, 2001 formula and the current formula, which I've called a couple times the "March 1, 2007 formula" because that's

the date it came into effect, your calculations are actually found in document KK, which is contained in Exhibit 33, correct?

A That's right. I've laid out exactly how I came to it, using the assumptions in JJ and so that you can see the math and check the math to see what I did.

Q Okay. If you can turn, then, to document KK within Exhibit 33.

A Okay.

Q And just to verify, there is a variety of information here, but you have one section sort of towards the bottom, where it says "price at test hundredweight" and under "blend" you have, in fact, the "$0.56" reference, correct?

A That's correct.

Q We'll get to the math in a minute, but that is the bottom line conclusion, at least with respect to a per hundredweight effect on blend, of Exhibit KK, correct?

A That's right. That's what my clients always want to know, what's it do to the blend.

Q And in your exhibit, your testimony Exhibit 32, you had discussed how that translated into a negative impact on producers of "$13,245" on

average per producer, correct?
A That's right.
Q And that figure appears as the last line on document KK within Exhibit 33, correct?
A Right. Again, my clients want to know what the number is.

Because we're looking at a national here, and I used the national average as explained in that definition.

Q Now, I would like to focus on the top part of this KK for a moment.
A Okay.
Q And specifically, on the cheese-to-protein --
A Okay.
Q -- portion of it. There are various -- in the very first row there are various headings, one of them is "cheese-to-protein," correct; that has just the words "cheese-to-protein"?
A Yes.
Q Did you prepare KK?
A I am fully responsible for all of these exhibits from beginning to end, yes.
Q Were they checked with anyone else?
A I had a number of people check some of them, all of it; some of them, parts of it, to make sure

that I wasn't missing something, yes.
Q Was KK check specifically?
A Yes.
Q I'm curious, by whom?
A Well, internally with staff. In terms of the computation of the blend and making sure I was doing that right, I used Professor Bailey because he had used those numbers. He had done a similar thing and I wanted to see if I was doing it correctly. And I have asked others, some of them even here at the hearing, openly, just said "If you see anything, I would like to know it." Because I've laid it all out, I want to make sure that what I provide is accurate.
Q Now, under "cheese-to-protein" you have two columns one called "current" and one called "changed".
A That's correct.
Q The "current" reflects the current formula as of March 1, 2007, correct?
A That one is correct. That is right.
Q And the "changed" reflects what you believe is the impact of the formulas as of January 1, 2001; is that correct?
A It was, as I recalled them; and I thought I had

checked these against the CFR, but, yeah, I tried to quote out to make sure I had the right numbers of how we ended up at that point prior to the decision that was made in March of 2003, at least in terms of what the -- I know that the formulas part, as far as the yields and stuff, that that's exactly the way those were; and I believe that's also how the make allowances were.

Q And there is a row called "DIFF," I assume that stands for difference, correct?

A Yes.

Q And that purports to indicate on a per hundred pound basis -- strike that.

The difference row purports to capture on a, is that per hundredweight?

A Per pound.

Q Per pound; that's what I was thinking. Per pound basis?

A Per pound component price.

Q Per pound component price what the difference is between what the formula currently produces and versus what it would have produced had the January 1, 2001 formula been in effect, correct?

A As I understood it, yes.

Q And so, for example, with respect to cheese-to-protein, you're saying that the price would have been $0.719 higher under the January 1, 2001 formula versus the formula now in effect, correct?
A If the factors that show in that row under "changed" and unfortunately the word as doesn't show in there, in the "cheese-to-protein" section under the word "changed," I listed all the factors, and if those were the ones in effect, it would have yielded a component price of $2.1592, and the ones that are in effect March of 2007 would yield $2.0873.
Q Now, I want to focus specifically on the -- on what you list at butterfat recovery.
A Okay.
Q Now, you have for both current and changed, a butterfat recovery of .9, correct?
A The number that shows there at butterfat recovery, it does show .9, but it's not the butterfat recovery for purposes of yield.
Q Do you believe it to be the butterfat recovery for purposes of the formula?
A No, it is in the "as changed," it is not in the current.

Q Are you saying that the formula on January 1, 2001, contained a .9 adjuster in the protein formula?
A You mean butterfat recovery -- oh, you mean the cheese-to-protein formula?
Q Yes.
A All right. I've been advised by my attorneys to make sure I understand the question, so I'm going to ask -- if you don't mind, I want to ask some clarification.
Q All right.
A The .9 appears explicitly or expressly in both formulas in the CFR, okay. That is -- then there is a butterfat recovery that is implied in the butterfat yield in both formulas. And the butterfat recovery in -- so my question is: Are you asking me the factor that's expressly stated or are you asking me in determining the yield the number that's implied in the butterfat recovery yield?
Q I'm asking you in the explicitly stated.
A That's .9.
Q Okay. You have included as Exhibit -- as document D, the pricing formulas as they have existed over time, correct?

A Right.
Q And if you would look at document D, which is contained within Exhibit 33, and the one that's called price formulas 2001, could you identify for me where in the Class III price formulas, as set forth there, the .9 factor appears?
A Under the price -- where it says "price formula 2001," it shows over -- it shows under the price formulas 2004. It's been my understanding, and I think I had the CFR that indicated that it was effective 2001.

You know, I printed these off. I didn't check to see whether they were correct or not.
Q Well, if you look at the 2004 price formula, which is also in document D.
A That's right.
Q You see that the .9 adjuster is in there with respect to the protein price for Class III, correct?
A That's right.
Q There is a multiplication by .9?
A Right.
Q And if you look at the current price formula, 2007, which is your last two pages of document D, you see the .9 adjuster appears for protein

price for Class III?
A That's right.
Q But you've confirmed for me that that adjuster does not appear in the price formula 2001 as included in document D?
A It doesn't there, and it's my recollection, Mr. Rosenbaum, that that took effect back in January 2001. And if the CFR for that period would correct me, then I would stand corrected.
Q Well, if in fact the CFRs would indicate that it was not until April 2003 that that first came into effect, that would suggest it wasn't in effect in 2001, correct?
A That would be the best evidence of what the fact was.
Q Now, if we go back to KK, I would like you to assume with me that the evidence will establish that document D is accurate, and that the .9 factor didn't exist as of January 1, 2001.
A Okay.
Q Now, if that is the case, and I'm looking now at the "changed" column under "cheese-to-protein" under KK, you have a butterfat price of $1.3472, correct?
A Yes.

Q And you then multiply that times .9, correct?
A That is correct. And that gives you the fractional value at $1.2125.
Q If in fact the formula in 2001 had no .9 adjuster, then the fractional pound of butter figure would be $1.3472, correct?
A You're absolutely right.
Q And if that's the case, then the Class IV butterfat to Class III, which is the next line down --
A Right.
Q -- would be -- make sure I have my math right. It would be $1.7117 minus $1.3472; is that right?

Is that how your document works?

A That is correct; that would make that .3645.
Q That's what I've gotten as well. Your next line "fat-to-true-protein ratio of 1.28;" that will stay the same.

But your next line, protein before -- I'm sorry, your "protein before adjustment" will stay the same, but your "adjustment to protein" will now be .3645 times 1.28, correct?

A Right.
Q And it will become .4666 instead of the .6390

that you have?

A That's close enough.

Q Okay. And accordingly, the component price is a combination of 1.3472 and .4616 -- I'm sorry, I started that wrong.

Your component price will be 1.5202 plus .4666?

A Right.

Q Which is 1.9868?

A That is correct.

Q The implication -- a lot of math, but we're getting closer to one of the initial implications, obviously, when you look at the 1.9868, which is what the January 1, 2001 formula provides, versus the current formula 2.0872, we now see that in fact the change in the formula from January 1, 2001 to March 1, 2007 has increased -- excuse me, start that again.

It's now a negative number, correct? The difference is now negative.

A Well, yes, depends. Yes, the difference right now is .0719, and if in fact in 2001 the formula was different, then the "changed" column would be different and you would have a higher value,

yes.

Q And that number, rather than it being a positive 7.19, becomes a negative $0.1005?

A I haven't done the full math, but your math would be correct.

Assuming that the .9 is in there and that should have been a 1, then you're right.

Q Now, and if you look, then, at your "at standard" test information.

A Yes.

Q The figures -- the based on changes number for both Class I and Class III are, in your document, $12.28, correct?

A Yes.

Q And am I correct, though, that if you adjust for what we've just been talking about, that number instead becomes $11.76 instead of the $12.28?

A I didn't do the math, but it would reduce the amount, yes, as would the rest of the exhibits on those numbers.

If you change the numbers, and as changed, you will get a different result. And based on what you've given me, those would be the different numbers.

Q Now, if you take, as correct, and we'll put in

some evidence on this, that the based on changes number for Class I and III should not be, as you show it, $12.28, but instead should be $11.76 based upon the actual formulas of January 1, 2001, the difference between the price under the formulas of January 1, 2001 and the current formulas would only be $0.12, not $0.64, as you indicate?

A You change the numbers, you'll get a different result; that's why I laid it out the way I did, so if somebody thinks the numbers should be different, they can make those corrections.

Q The difference for Class I and Class III at standard tests, as we've gone through the math here, you've overstated it by in excess of 500 percent, if the math I've done is correct; is that right?

A I have -- if you're correct, the number may not -- the magnitude may not be the same, but the fact still stand that the purpose of the testimony that we've presented, and where these exhibits go, that the -- that that does not change one way or the other whether or not we should adopt the changes we've proposed.

It was the idea to create a baseline for

purposes of establishing an example so the people that understand this exhibit as it appears throughout this proceeding, in its various modified thing, or establish a baseline. As I said before, that was how I recalled the 2001 statements to be.

Q We've already seen, though, that you did in your Exhibit 32, try to justify your proposed changes in part by comparing them to what the changes had already been made in the opposite direction, so to speak, by the amendments to the formulas that have taken place between January 1, 2001 and March 1, 2007, correct?

A Sure. I took the numbers that the table generated and I used those numbers. That's what it told me and that's what I used; that is correct.

Q Now, I'm not going to try to take you through the price at test calculations, but you would agree with me that the effects that we've already discussed in the context of standard tests, would also be experienced in your calculations prices at test, correct?

A The way this spreadsheet is established, you change any of those factors up above and it will

change everything in the three tables below; that's right.

Q And the cost per average producer of $13,245, that would be materially reduced as well?

A I would disagree with the term "materially." I think any reduction to producer income is significant, but it would be a reduction of what I stated in my testimony.

Q And that number may be too high by -- that number could easily be four times too high?

A I have not done the math. The table is set up. You evidently have, anybody can do it; that was the purpose of the table to give that ability to people to compute what those results would be.

Q All right. Now, did you calculate this for any other year other than 2006?

A No, I did not.

Q Okay.

A I had thought about it. Originally, we were going to look at even looking at 1998, because that's when the data was first available, all the way through 2006, and we decided to simplify it and keep it down to just one number, because the implications are apparent and the prices at test and the effect on blend will vary from

order to order, depending on what the utilization is in the order.

Q Would it surprise you to learn, for example, that if you were to pick another year, for example, 2004, rather than 2006, with respect to -- actually, let me back up.

Document JJ shows the assumptions you were using from 2006 data, correct?

A That's right.

Q And that's what feeds into this KK, correct?

A That's right.

Q And would it surprise you to learn that if you followed your methodology, but used the average for 2004, rather than 2006, what you would find is that the changes in the formula between January 1, 2001 and March 1, 2007 have increased how much producers get, not decreased it?

A It would surprise me that the changes would result in an increase throughout the year, but I will acknowledge that the data or the markets vary widely from year to year, and we picked the most recent data and I think I explained the reason we picked 2006 because that's where we also had some cost data and some other things that seemed to be working with us.

Q Now, let me focus on another set of entries in KK, document KK, and I want to look at the -- I want to use Class IV as an example.

You show that it's standard test, the obligation -- I'm going to start that again.

On document KK, I want to focus on the entry called "prices at test CWT," all right?

A Okay.

Q Now, your information at standard test is assuming 3.5 butterfat milk, et cetera, correct?

A Whatever the numbers were in JJ.

Q Well, no --

A Yeah, whatever the numbers are in JJ, prices at test are assuming whatever the numbers are in JJ. If you're looking at tests, the averages are listed there for each of the classes.

Q That's standard test, correct?

A Standard test; it's listed as whatever those numbers are.

Q Okay. And I think I've confused things by order of questioning. Let me take another shot at it.

In document JJ, you have some numbers that say "standard butterfat 3.5 percent, standard true protein 2.9, 9.15 percent," et cetera?

A Right.

Q Those are the numbers that went into your calculation on KK that are called "at standard test," correct?
A That's correct.
Q Then you have a second set of numbers called "prices at test hundredweight," correct?
A That's correct.
Q That's your effort to capture what the milk composition really was versus the, if you will, standard assumptions, correct?
A That's correct because each class has its own utilization of the components and how they move can make a difference how it works.
Q All right. Now, with respect to Class IV in document JJ, you list some figures as to what the average butterfat test was, 5.21 percent, correct?
A Right.
Q And the average solids not fat composition of 8.62 percent, correct?
A That's correct.
Q Those are the assumptions that go into your calculations with respect to prices at test; is that right?
A That would be correct.

MR. ROSENBAUM: I would like to mark a document as whatever our next exhibit is, Your Honor.

MS. PICHELMAN: 58, Your Honor.

JUDGE PALMER: All right.

(Exhibit 58 was marked for identification.)

Q Now, Exhibit 58 is simply a copy of section 1001.60, and you, I'm sure, can confirm that that's the Northeast Order, correct?

A Yes.

Q And I simply want to make sure that we -- see if we are applying the same rationale.

This sets forth what the handlers' obligations are with respect to each of the classes, correct?

A That is the handlers' value of the milk at class and based on their use; that is correct.

Q So this is a copy of two pages of the CFR 54 and 55, on what's page 54, you see 1001.60(b) -- excuse me, 1001.60(d) it sets forth the class for value, correct?

A For purposes of establishing the handlers' value of milk; that is correct.

Q Right. And it says that for a Class IV value you "Multiply the pounds of nonfat solids in

Class IV skim milk by the nonfat solids price" and you add to that the "amount obtained by multiplying the pounds of butterfat in the Class IV by the butter price," correct?

A That's for establishing the handlers' value of milk under the order, that's what it says; that is correct.

Q Okay. Now if one follows that approach and uses the number you have in JJ, then for nonfat solids, it is 8.62 percent, correct; that's your percentage of solids not fat?

A Okay.

Q Times .7231, which is the component price under the current system that you show on KK in the fifth column over, correct?

A 7231, yes.

Q Okay. And since you've got a calculator, could you just -- if you could confirm for me what we got when we multiplied 8.62 pounds of solids not fat, which is, of course, how many pounds you have in a hundredweight of milk at 8.62 percent.

A What are you asking me to multiply?

Q The 8.62, which is your -- that's your pounds of nonfat solids.

A Okay.

Q Times the nonfat solids price of .7231 per pound.
A Okay.
Q And we get 6. -- depends on how far you want to go out, 6.23312.
A 6.23.
Q Okay, we'll stop at 6.23. Now, that's the nonfat solids pound. And then, according to the formula, we add to that the pounds of butterfat times the butterfat price. So the pounds of butterfat, according to JJ, are 5.21 pounds.
A Okay.
Q Times what you show as the butterfat price of $1.3189 per pound.
A Okay.
Q And we get $6.87, rounding it off. Is that what you got?
A No, I had a -- it squared it. What did you get?
Q $6.87.
A That's what that calculation shows.
Q And then the last thing is, if you add the $6.23 value or -- yeah, value of nonfat solids to the $6.87 value of butterfat, you get a total Class IV value of $13.10, just adding those two numbers together.

A Okay.
Q Now, you agree with me on that that's the simplest calculation?
A If you use the calculation that you're proposing, yes, that's what you get.
Q Okay. So that would suggest that if there had been one handler buying all the Class IV milk for 2006, that handler's obligation for Class IV at test would be $13.10 per hundredweight, correct?
A Using the methodology that you're doing, that would be the number. I described what I meant by the word "blend price" and how I computed the class prices. And they may or may not agree with the handler payment into the pool, but, you know --
Q I guess I don't understand that. When you're calculating -- I mean, the class price -- the producer gets the blend price, right?
A That's right.
Q And the handler pays the class prices, correct? And if you can explain to me, please do, but I don't understand how any approach can be taken to determine what the Class IV price at test is under the current formula other than the

methodology we just went through, which results in a price of $13.10 as opposed to the $12.78 that you have in your table.

A I explained the approach that I did. It's at page 12 of my testimony, and that's the approach that I took; and if somebody wants to do a different approach and do different comparisons, have at it.

I mean, that's the way I laid it out. I did not look at the handler pool and I think I made it pretty clear in the testimony I was not trying to estimate a statistical blend for which milk is paid under the Federal Orders and we used a different approach.

Q I understand, for example, you didn't include Class I differentials.

A Right.

Q You didn't include location adjustments, and you've been very plain about that, your table is consistent with that as to Class I.

But when it comes to Class IV, the regulation is what it is. Isn't the way that I just had you do it the right and the only way to do it?

A No, it's not the only way to do it for the

purposes of this table.

Q Well, if you want to know how much is actually paid for Class IV milk at test in 2006, were the current formulas in place, the answer would be $13.10; you would agree with that?

A If that's the question that you're trying to answer. That's not the question that this table was trying to do.

The table was trying to do is the way I explained it in Exhibit 32. And that's what I did. Somebody might have a different way of doing it, evidently you do, and you're more than welcome to take what I've done and apply a different methodology.

I'm not hiding anything. I showed exactly the way I did it and it is different than what you did.

Q Maybe we can just resolve this.

When USDA is determining what handlers' obligations are with respect to Class IV milk, they apply the methodology that I just had you go through; is that fair?

A I would certainly hope so.

Q All right.

A And believe that they do, I mean, based on my

checking of them from time to time.

But that's not what I purported to do. I would have done it completely different if I were going to do it that way, and I didn't do it that way. I told you how I did it, and that's the basis for what I did.

Q Well, on page 12 you have the statement "The formulas for the class prices of tests are as follows."

A Right.

Q Then you list a formula for Class IV test. Where does that test appear in the regulations?

A I didn't say that it appeared in the regulations.

Q All right.

A And I will also say that that's the formula that was consistently used for the "current" and for the "as changed" on this, and all the other 10 or 11 tables that did it.

Q That was actually where I was headed. I mean, you have many tables OO, BBB, EEE, TTT, WWW, ZZZ, AAAA, DDDD, EEEE.

All of them start with the same prices at test per hundredweight numbers that appear on KK; is that right?

A I would hope so for the current, that was the intent. I was trying to establish a baseline from which you can compare.
Q If that is the wrong baseline, then it would impact all of those tables that I just read?
A It's not the wrong baseline, it may be a baseline different than what you may want to use.

I've laid out my baseline and that's my baseline.
Q Well, a handler pays money into the pool based on his obligations, correct?
A Yes, but that's not what we're talking about in the way this table is set up.

Yes, they pay based upon what they get.
Q A producer does not receive money -- a producer has no particular receipt that's tied to Class IV, it's tied to the blend of all the classes, correct?
A That's correct.
Q The only Class IV price that's calculated under the system is the price that's calculated with respect to the handlers' obligations; is that right?
A In my view, we're comparing two different

things, Mr. Rosenbaum.

I have laid out a model and a baseline whereby as we get into what really counts today, and that is the proposed changes that we wish to make, there is a basis whereby we can compare a potential impact that that would have on producer income; and I laid out how I did it.

I'm satisfied that it accurately represents what I want to represent to the Department. I laid out every step of my math, every factor that I used, every formula that I used; and if somebody wishes to do it differently, I think that's wonderful and they're welcome to do it. But I didn't, and I'm not going to accept it. I'm going to go with what I did, I did it, and that's what it is. And I did it consistently. I did it consistently for the current and the changed so that there's a true comparison between the two, and I did it between -- for each and every one of the 10 or 12 changes that I did.

When you look at those, it gives you some sense of what's going on. At the end of the day I would agree, that if I had computed a blend price for a given order under a given time and

counted all the factors and did it in the methodology they did, I would probably arrive at a different answer. But I didn't do that.

Q Why don't we switch to the issue of the percentage Casein-and-true-protein issue.

You proposed a change in how that's addressed, correct?

A Yes, we do.

Q And so we can orient ourselves, the current formulas include a factor that represents the percentage of Casein-in-true-protein, right?

A Would you say that -- ask that question again, I'm sorry.

Q The current formula includes a factor that represents the percentage of true protein that Casein constitutes?

A I would state it this way: Is that the current formula has assumed a percent of Casein for all milk for purposes of computing the value of protein in the formula.

Q Well, you have a heading on page 31 of your testimony, Exhibit 32, called "use the correct Casein percent in true protein of milk at average test," correct?

A What page?

Q 31.
A Yes.
Q And the current formula has a percent Casein-in-true-protein number, correct?
A It has a number .822, and I explained why that was not correct under the methodology that I felt that they should use, and it should be 83.2.
Q You want to change the .822 to .8325, correct?
A That's right.
Q But we are talking about the Casein percent in true protein; that's what we're trying to arriving at, correct?
A That's right.
Q And you're not suggesting that we change away from the use of the Casein percent in true protein, you're not saying that's a mistake in concept, rather what you're saying you think the numbers should be different, correct?
A No, I think the Van Slyke formula requires that it takes the percentage of Casein in the protein that you state is the formula, derive at the yield, at least the protein yield of the formula.

So, yes, you should have the Casein in

there.

Q When you say "Casein in there," is the Casein percent in true protein; that's the number that goes in the formula?

A Well, in the Federal Order we do not test for Casein, we test for true protein, or that's what we report. And then the -- yes, then we pay on true protein, but the formula to come to the yield you need to know what the Casein percentage is.

Q And in the formula right now, it's .822, correct?

A The current formula presumes a .822 based upon the statistical ratio or percentage of true protein for statistical purposes.

Q Now, you're aware of the fact -- let me just read from you -- read from the November 7, 2007 [sic] Federal Register, USDA's justification for the current number of .822. This is 67 Federal Register 67928.

A 2007?

Q If I said 2007, I misspoke.

A I thought maybe I missed one. It's been going so fast, I may have.

Q November 7, 2002.

A I heard the 7, okay.
Q I may have misstated it.
A All right.
Q In any event, that's the right date.
A That's the one that led to the March 2003 results.
Q Exactly.
A Okay.
Q And what USDA said was "an expert witness testified that the Casein from true protein ranges between 0.822 and 0.824." And then they reference an argument that was made by one of my clients. And then they say "This final decision finds that using a Casein percentage of 82.2 is appropriate. The 0.822 is at the lower end of the range indicated by the expert witness and is appropriate for use in determining minimum Federal Order prices."

Okay, I'm trying to orient ourselves as to how we got to the .822 to begin with.

A I got the number out of the Federal Register.
Q Now, you're aware of the fact that the expert witness referenced there was Dr. Barbano, correct?
A I believe it was either -- there were several

people that talked about that. I remember Ms. Taylor talking about some of those issues, and I think even Mike Brown had testified on those issues, and I think some others. But that was -- I can't tell you exactly who it was that said that was the number.

Q But, once again, we're trying to arrive at the Casein percentage true protein, correct?

A That's correct.

Q Now, Dr. Barbano had actually conducted a laboratory study of the Casein percent in true protein, hadn't he, the very thing we were trying to figure out?

A But what you're not telling me is what the true protein tests are, so I don't -- to me, the statement that you read from the Federal Register is an incomplete statement, as far as I'm concerned, to tell me anything.

Q Well, before you did your proposal, did you go back to look at what Dr. Barbano said his test had been to determine the Casein percentage true protein?

A I'm trying to remember all the things that I look at and all the people that I talked to and the 82.2, I believe I explained it in my direct

testimony, is based upon the -- it was an adjustment off of the percentage of 78 percent of crude protein.

Q Well, that's what you're trying to do, isn't it?

A That's exactly what I said I'm going to do.

Q Right. But I'm trying to get at what the current number is based upon, and since we're -- let me ask you this: Since we're trying to decide what the Casein percentage true protein is, wouldn't the most logical thing to do is to test milk and find out what the Casein percent in true protein is?

A If there was public data we could have the people here to testify to that, that would be extremely helpful.

Q Well, if that was testified to in putting in place in the prior formula, that would count too, wouldn't it?

Let me restate that. If in fact that was precisely the evidence presented in establishing the .822 --

A My answer to that, you know, in light of what I know now and what we've argued in our case, I don't think that that would fully answer the question, no.

Q All right. Let some ask that -- I have two exhibits to mark, actually, three.

MR. ROSENBAUM: Let me mark first Exhibit 59.

(Deposition Exhibit 59 was marked for identification.)

MR. ROSENBAUM: And then 60.

(Deposition Exhibit 60 was marked for identification.)

MR. ROSENBAUM: And 61.

(Deposition Exhibit 61 was marked for identification.)

JUDGE PALMER: Can you tell me what those exhibits numbers are again.

MR. ROSENBAUM: Exhibit 59, the first one, "Class III Milk Pricing: An Evaluation of Assumptions and Calculations."

JUDGE PALMER: Okay.

MR. ROSENBAUM: 60 is the article from the *Journal of AOAC International*.

JUDGE PALMER: Okay.

MR. ROSENBAUM: And 61 is the document that's called "Trend and Milk Composition and Analysis in New York."

JUDGE PALMER: Okay. I marked them as

that. I'm not admitting them at this time, they're just being marked.

MR. ROSENBAUM: I understand, Your Honor.

Q Now, I will represent to you what I marked as Exhibit 59 was Exhibit 15 to the -- in the May 2000 hearing.

A Okay.

Q If you see on page 17, Dr. Barbano says, very bottom of the page, "In a National Milk Composition Study I conducted in 1984," et cetera.

Do you see that?

A Yes.

Q And then he says "Since 1992, my laboratory has monitored the Casein as percentage of crude and true protein from milk from several factories that participated in the 1984 study."

Do you see that?

A Yes, I do.

Q And then further down he says "More recently my laboratory has monitored the Casein as a percentage of true protein in bulk milk supplies in New York State at three large cheese factories."

Do you see that?

A Yes, I do.
Q And that data was reported in October 1999 at the Cornell University Animal Nutrition Conference, and that the publication is reference 4.
Do you see that?
A That's right.
Q And then if you look at the very last page of Exhibit 60, you can see that what is referenced 4 is the document I've now marked as Exhibit 61.
A Okay.
Q And then you see that he goes on to describe, he says the methods that he used to determine this data, correct?
And he says "these methods are described in reference 5, 6, and 7," correct?
A I'm starting to lose you. Where are we at? What page?
Q We are at page 18 of Exhibit 59, which was Dr. Barbano's testimony in May 2000.
A Okay.
Q And do you see that he says in the middle of the first paragraph "Test values reported for the 1992 to 1998 period below were determined using" so and so methodology.

Do you see that?

A Yes.

Q And he --

A Then it goes "Over that seven-year period the average" --

Q We'll get to that in a second. I'm focusing here first he identifies the methods he used, correct?

A Okay.

Q As references 5, 6, and 7.

A Right.

Q And can you confirm for me that what I've marked as Exhibit 60 is reference 7?

A It appears to be. I mean, I can't confirm that in fact that's it, but I mean it appears to be a copy, at least the headings agree with your footnote, yes.

Q Now, Dr. Barbano testified that the average annual Casein is a percentage of true protein were the numbers that he listed here 82.17, 82.17, 82.42, 82.15, 82.12, 82.31 and 82.19, for a seven-year of 82.22.

Do you see that?

A Yes, I do.

Q And those, in fact, are consistent with USDA

stating that "an expert had testified that the Casein from true protein ranges from between .822 and .824, correct?

A It says that. It doesn't -- go ahead, that's what it says.

Q It's consistent with that being the source of the numbers, correct?

A I think it's a mischaracterization and a misuse of the statement that was made by Dr. Barbano, but, yes, it does purport to say that.

Q Dr. Barbano said, and I quote, "The average annual Casein is a percentage of true protein for the milk supplies in these three factories was," and he lists these various numbers, correct?

A What was the true proteins?

Q He measured the true protein.

A What is the percentage of what?

Q Casein is a percentage of true protein. That's what we're interested in.

A And what is the true protein that he calculated --

JUDGE PALMER: Now we're getting -- I don't think you should be asking Mr. Rosenbaum questions.

And I have problems with the exhibits, I'll tell you that. Because I don't want us to be in a position of taking exhibits from another hearing and somehow putting them in this hearing without the sponsoring witness, because otherwise they become very hard to understand; and so I have problems here.

But on the other hand, you're allowed to look at them and cross-examine the witness.

Q Do you agree with me that it is technologically feasible to test for true protein and Casein in a given quantity of milk?

A Yes, I would hope so.

Q And do you agree that Dr. Barbano said that's what he had done?

A I understand that's what he said he did. But the full data that you're trying to quote, it's not giving the complete picture, Mr. Rosenbaum.

I can't say that what the Department did was correct because I believe it mischaracterizes and takes the testimony out of context, period.

Q What's the lack of context here?

A Take a look. Let's look at Dr. Barbano's testimony at page 17, okay? You'll notice in

there he has a formula that talks about a "butterfat recovery of 93 percent" that he testified to.

And right below that he makes the statement "the average Casein is a percentage of crude protein with 77.93 percent," which I rounded up to 78 percent.

Look at my exhibit, you take 78 percent of crude protein, that's the test, and that's the data that's out there. It varies as a percentage of true protein because the differerce between crude protein and true protein is basically a fixed number of about .19; and as the percentage of protein goes up and it goes down, the percentage of Casein in true protein goes up and it goes down. And our testimony was, was that where the Department pegged it was not at the average protein test used in the United States at this period.

And that basis, using its standardized milk, Dr. Barbano's testimony comes out as 82.2. But you take what he says here and you apply it to the actual protein test that we have in the record, and the average test, and the methodo_ogy used, you arrive at the number I

proposed 83.25 percent, and I believe Mr. Metzger testified the other day it was 82.9 or something like that.

JUDGE PALMER: Help me out here. I'm looking at page 17. The number I see is 77.78.

Where did you get these other numbers?

A Down here at the last sentence. It says "Casein is a percentage of crude protein with 77.93 percent."

JUDGE PALMER: 77.93.

A And if you bear with me -- anyhow, the exhibit that I used, I used 78 percent.

JUDGE PALMER: You used 78. Where do we get to these numbers of 80?

A I don't know.

JUDGE PALMER: Next page.

A That's the next page. I just explained why I believe that what Dr. Barbano said continues to support the position that I take.

Q Have you conducted any laboratory tests that measured Casein as a percent of true protein?

A I am not a food scientist.

Q You must have access to them.

A I read things. I was there when Dr. Barbano made the testimony.

Q I don't mean to suggest you personally, obviously, conducting the lab tests.

Have you commissioned any lab tests?

A I have not commissioned any lab tests on Casein. I think it would be a wonderful thing for the Department to have that information available for these hearings.

Q Let's look at how you went about coming up with your .8325 number.

A Okay.

Q Now, it's on document KKK, correct?

A That's right.

Q DDD, I mean. Is that the right document, DDD?

A That was the one I was looking for a minute ago; that is correct.

Q Now, you want to replace the .822 based upon Dr. Barbano's testimony with .8325, correct?

A That's right.

Q And the way you get there is you start with the assumption that the percent Casein in crude protein is 78 percent, correct?

A That's what Dr. Barbano said.

Q Well, we'll get to what he said in a minute, but that's how you're doing it, correct?

A That's how I'm doing it.

Q And then you apply an assumption that adjusts for the difference between crude protein and true protein, correct?
A What? I went from crude protein to true protein based upon the .19, right.
Q Then I've probably not done it in the order you did it, so why don't we follow your document.
A All right.
Q On DDD you have a percent crude protein number, correct?
A Right.
Q And then you convert that to true protein by deducting .19, correct?
A That's right.
Q And the .19 represents nonprotein nitrogen, correct?
A That's what the documents that I have read have related, including those of Dr. Barbano, and I think I attached a document from Dr. Barbano that states as much.
Q And then you assume that the percent Casein in crude protein is 78 percent, right?
A That's right.
Q Now, so there are two underlying assumptions here that ultimately lead to your .8325 number.

One, that the percent Casein in crude protein is 78 percent; and two, that there is .19 nonprotein nitrogen in true protein?

A That's right.

Q Excuse me, in crude protein.

A The difference between crude and true has been .19, and that's been a number been fairly consistently used.

Q Well, I would ask you if you would look at Exhibit 61, which we've already identified as the Barbano study referenced in his exhibit.

A Okay.

Q And have you turn to table 6 and see if you will confirm for me that that would indicate that nonprotein nitrogen is not a constant, but rather varies?

A It does have a variability. It's a very tight variability. And in my conversations I had, and I'll state one of the people I had over the years because I've had this discussion in my modeling, was Richard Fleming, who is the author of one of these documents, and years ago confirmed to me that the factor of .19 was correct; and there's a document put out by -- used by Cornell written by Dr. Barbano

presented to show the .19, and it is a number commonly used by DHIA and everyone else. That's why I use it.

Q Do you agree with me that if one were to perform actually tests of milk, one would find that nonprotein nitrogen varies?

A In this particular case, yeah, it does vary.

Q In this particular case --

A It's a naturally produced thing and it's going to have variability.

Q It goes from as low as .87 to as high as .96?

A That's right.

Q Just in average. And if you look month to month, it can go as low as .180, et cetera, correct.

A It does vary. It's more a function of feed and what I understand that the veterinarians that do the feeding for the animals and establish the rations try to make sure it's at .19 because any additional tends to be urea and indicates an inefficient feeding of protein to the animals.

Q If you look at table 9, can you confirm for me that based upon his data, the average Casein as a percentage of crude protein also varied?

A Yeah, but that's not news. All of these vary.

The true protein test vary, the crude protein, butterfat test. They're natural animals.

Q What Dr. Barbano used to derive the average percentage Casein -- average Casein as a percentage of true protein, he actually measured that.

A I have not had a chance to study indepth what you have as Exhibit 61 to be able to explain to you how that works with what we have.

I have relied upon the testimony that he made that was part of the record in 2000 and the comments made by the Department and our research and all confirmed that 78 percent of crude protein was Casein. And the .19 was the difference between true protein and crude protein; and using those, I determined how much Casein one would anticipate in a variation -- at .05 a variation in crude protein rates and that established here the amount of Casein that was there, okay?

And then I did the Casein implied in the formula, which was used in the 82 percent of the true protein, and it showed this and most of the animals below the average test was less than the amount of Casein that showed up based on the

documents that I had.
Q But all that was predicated on your use of the .78 and .19?
A Based upon the testimony of Dr. Barbano that 78 percent of crude protein was Casein, yes.
Q You did not go to the underlying documents, I take it?
A He said it. I mean, said it there and understanding that the absolute -- you know, the relative it's not a percentage base.

JUDGE PALMER: I'll tell you what. Just to speed it up, don't argue with him right now. Try to answer him.

Through your attorney, we'll let you have a chance to say more.

A I don't recall reading the underlying documents. I have them. I've been aware of them, but I don't recall ever reading them.
Q If you turn to page 32 of your testimony, you say on the very second sentence "The amount of NPN" -- meaning nonprotein nitrogen -- "in crude protein varies by a study done by personnel at USDA, AMS and Cornell determine that a fair factor for nonprotein nitrogen" --

JUDGE PALMER: What page are we on? I lost

it.

MR. ROSENBAUM: 32.

JUDGE PALMER: 32.

Q -- "is an unchange in 0.19."

Do you see?

A Yes.

Q By the way, I'm just curious. What's the basis for saying this is a study done by USDA personnel? The authors are Dr. Barbano and Lynch.

A I think some of the underlying documents and such, if you look at Exhibit -- one of these I saw it here, Exhibit 60, and the authors are Joanna M. Lynch and David Barbano from Cornell University and J. Richard Fleming, U.S. Department of Agriculture, Texas Milk Marketing Service, Carrolton, Texas.

Q But the specific document you reference, CCC, I don't see anything that indicates USDA participation.

A It may not. It was available during that transition period as people were explaining the true protein because that was a mindset change that producers had to go through, and DHIA had to go through in that period of 1999 to 2000.

Q Okay.
A And it's also a number that Dr. Barbano mentions in his testimony, as I recall, in Alexandria in 2000, and it's a number in discussion that I had repeatedly with people, it's a number that is used.
Q And the document CCC says that if you add 0.19 percent to the true protein values, that will give you an approximate estimate of crude protein.
A That's right. And which, by the way, was the way that the milk testing equipment did it. That's the other part, the other part of the verification of the .19 was the automatic -- the -- they do this automatic testing now of nitrogen content in milk and they test -- the test only came out and gave the true protein and added .19 and reported crude protein; and that's one of the rationales for going to true protein as opposed to crude protein, so we wouldn't be adding .19 in the machine, but would be doing it on the paper outside.

MR. ROSENBAUM: I don't know if you want to take a break, Your Honor.

JUDGE PALMER: I do.

MR. ROSENBAUM: This is a good spot.

(A recess was taken.)

JUDGE PALMER: Back on the record.

We'll resume cross-examination.

Q I would like to talk for a moment now about your proposal 7, farm-to-plant losses.

A Yes.

Q To orient ourselves and state the obvious, farmers are paid based upon the quantity of milk they deliver, correct?

A Yes.

Q And that the measurement of that quantity takes place at the farm, for Federal Order purposes?

A Generally speaking, yes.

Q And, obviously, the milk has to be transported to the plant, right?

A That's right.

Q Once again, I'm just orienting ourselves. The current formula assumes that there is a 0.25 percent loss of milk plus an additional .015 pounds of fat, correct?

A And 100 pounds of milk, yes.

Q And those numbers were put into the numbers following the May 2000 hearing, correct?

A Yes, came out of the March 2003 decision.
Q And did your clients oppose their use at that time?
A Yes; not effectively enough, but, yes. We were not in favor of them at that time.
Q Now, on page 18 of your statement, Exhibit 32, you set forth there, and continuing on, your justification for why you think the farm-to-plant shrink should be eliminated, correct?
A That's right.
Q And you make a couple of points you may make more than those couple of points, but a couple of points you make is, number one, that there exist in the marketplace situations where the entirety of a load comes from one farm, correct?
A That's right.
Q And second, that the determination of the quantity is done using scales rather than dipsticks, correct?
A Yes, because it's generally silo milk and there's not a stick long enough.
Q Okay. And you contrast that with the situation where what you describe, I think, as typical past practice?

I'm not saying that's your phraseology.

A Comingled milk.

Q Comingled milk with multiple farmers' milk on one tanker and the measurements using a dipstick, correct?

A That's right.

Q Now, you assume -- I'm not challenging this -- that a full tanker has about 50,000 pounds of milk in it, correct?

A It depends. Yes, I use that as a number. It varies from state to state because different states have different axle limits, some it's 52.

Q We're not challenging that number, at least for purpose of this examination.

You also say the practice is that milk is kept on the farm 48 hours max?

A Yes, the PMO requires that milk be removed from the bulk tank within 48 hours of harvest.

Q So the result for a single farm to be able to produce enough milk to fill a tanker on its own, it basically has to be 25,000 pounds a day?

A More or less, yes.

Q Now, if we were to look at document N, which is included in Exhibit 33 of your exhibits, that document shows the average daily deliveries of

milk per producer for each of the Federal Orders, correct?

A Yes, I think I cited to it.

Q And what that indicates is that there are three orders that have producers that on average produced per day the 25,000 pounds of milk that is necessary to fill a tanker on their own?

A I count four.

Q I stand corrected, four. And then there are six that don't; is that right?

A Yes.

Q And if you then turn to Exhibit O -- it's not O, one second. Still on Exhibit N, take the Northeast as an example, their average production is less than one-fifth that needed to be able to fill a tank on their own, correct?

A That's right.

Q And the same is true for the Upper Midwest?

A Pretty well for all -- you know, those other six, yes.

Q They're all in the range where they are not only too small to fill a tank by themselves, but they are only roughly 20 percent as large -- they are, in fact, one-fifth of what they would need to be in order to be able to fill a tank on

their own, correct?

A That is correct.

Q And then if one were to look at document L, also in your collection of exhibits, 33, that provides the number of producers that are regulated -- one second. Hold on one second.

Document L tells you how many producers are delivering milk under each of the orders, correct?

A Yes.

Q And take the Northeast as an example, there are 14,284 producers on average in 2006, correct?

A Yes.

Q And we've already established that on average they produce roughly one-fifth the amount of milk that they would need to, to be able to fill their own tanker, correct?

A I think that's what the exhibit reflects.

Q So my point is that of the 52,725 producers who deliver under the Federal Order system, according to document L, it's fair to say that tens and tens and tens of thousands of them don't fill a tanker by themselves?

A I haven't done the number. I mean, we don't have the stratification that can help us do

that, but I would have to assume that it is tens of thousands that are in that category, yes.

Q And maybe to try to get us a little closer to an actual number, if we could turn to document NN in your collection of materials.

Now, you are taking -- and I'm not challenging this number at this point. You have an assumption that a farmer can produce 65 pounds of milk per cow per day, correct?

A That's what I stated in the testimony.

Q So in order to fill a tanker by yourself, you have to have, as I calculate it, and I think maybe you also did this, too, 385 cows a cow herd because that's 50,000 pounds to fill a tank divided by 65 pounds per cow, divided by two days because you get to use two days to fill a tank, right?

A That's a good number.

Q Now, according to document NN, there were 75,140 dairy operations in 2006, correct?

A That's what it says.

Q Once again, we've established 385 cows in your herd as a rough number as to how many cows you need to be able to fill a tanker by yourself, correct?

A Right.
Q Now what this document does for us, among other things, is tell us how many operations fall within various categories of size, correct?
A That's right.
Q And so for 2006, there were 573 farms with over 2000 cows, correct?
A Right.
Q And, obviously, they exceed 385 cows per herd?
A Right.
Q There are 870 between 1,000 and 1,999, right?
A Correct.
Q And then 1,700 between 500 and 999 cows, right?
A That's what it says.
Q We know that those farms could all fill a tanker by themselves, right?
A Yes.
Q And by my math, 573 plus 180 plus 1,700 equals 3,143.
A Right. And they produce about 51, 52 percent of the milk.
Q But in terms of operations, at least, they represent only 4.1 percent? You would agree that's the math? It would be 3,143 farms divided by the 75,140 total farms, correct?

A It's showing a tremendous concentration of the supply of milk in the United States.
Q But it also shows how many of the actual farm operations exceed 300 -- have enough milk on their own to fill a tanker, correct?
A It can give you an approximation.
Q Now, in fairness to your approach, there's another category of farms with between 200 and 499 cows, correct?
A Right.
Q And there are 4,577 that fall within that category, right?
A Right.
Q Now, obviously, we don't know with precision how many have the magic number of 385 cows, but let's say it's half, just half of them do and half of them don't.

If you did the math, that would mean you would toss in, let's say, an extra 2,700 or so operations?
A Twenty-three hundred.
Q Twenty-three?
A Twenty-two, twenty-three hundred.
Q Well, 4,577 divided by 2 is about 2,700?
A No, 23.

Q You're right, 2,300. And I get that that kicks up your total to about 5,400 operations, correct?
A I think that was an -- did I state that in my testimony? I think that's a number I came -- I may not have got quite that high, but that's a number; 52,000, 54,000 is a number I was thinking.
Q And, once again, if you wanted to figure out what percentage of total operations you were covering that had at least 385 cows, you would divide that number by the 75,140 total operations, correct?
A Right.
Q Now I get about 7.2 percent of operations, therefore, dairy operations, dairy farms that have 385 or more cows.
A If you're going to do it on just a straight number, I mean, that's what it would yield, yes.
Q So if you want to do it in terms of operations, it's roughly seven percent of operations, dairy farms, have enough milk to fill their own tanker and about 93 percent don't.

Is that a reasonable way to interpret the data?

A What was the number again? What percentage did you say.
Q I'm saying about seven percent of dairy -- of farms --
A That's close enough. I'm not going to disagree with that.
Q So four --
A They also produce about two-thirds of the milk.
Q And you can look at it either way, I suppose. If you look at it in terms of operations, then you've got whole orders that are essentially not filling up a tanker by themselves, right; we saw that in the Northeast?
A I think it is a viewpoint. I think that's what the fundamental part of our testimony is, is that you need to look at the average milk that's going into the plants and average productions and yields and stuff because that's the only benchmark that we can do without becoming arbitrary.

So it's the milk. Go ahead.

Q You've laid forth -- I understand you've looked at it from a percentage of production perspective.
A Yes.

Q And that's the argument you're advancing, I understand it.

A That's where we're at.

Q I'm just seeing whether you agree with me that if you instead decide -- if USDA were instead to decide to look at it in terms of, if you will, typical behavior among dairy farmers, the data would tend to suggest that over 90 percent of dairy farmers don't fill up their own tanks and don't have their deliveries measured by scales, but rather still using the dipstick in the tank that has comingled milk with other farmers?

A And I disagree with that. And the reason is, is that it's not their smallness that's the problem, it's the fact that we excuse it that it's the problem.

I mean, we had Mr. Schad up there with Land O'Lakes with those small farms and there was some significant farm-to-plant losses. Why are they? Well, it's the dipstick. It's the testing. It's the business decision that we're only going to test every third or fourth sample. It's the tolerance of .25 percent. And the system allows it.

We can't afford that in a 21st Century

dairy industry. The regulation should not mask that inefficiency; and I would suggest that if the Department did not excuse it, it would disappear and very large and very quickly.

Q Well, I think your testimony itself indicated that there were inherent losses simply from the use of the dipstick method.

Don't you agree with that?

A It's inherent losses, not just its use, but its oversight and the management of its use.

Q Are there inherent losses simply in the delivery of the milk from the bulk tank to the tanker?

A Our experience -- you know, I was trying to get ahold of the number, we had it at one time. It is very minuscule when you do a full tanker; it's very minuscule.

Q I appreciate that. But when you're picking up 10 farmers' milk a day, surely you would agree with me there is inherent loss suffered.

A There are losses when you pick up any producer.

Q For example, you're not allowed to burst rinse the bulk tank on the farm, correct?

A What do you mean by "burst rinse"?

Q I mean burst water in to flush any remaining chemical.

A No, you're not allowed to force what's left -- no, I agree with that.

Q And that may be an essential irrelevancy if you've got a huge silo on a huge farm, but if you've got individual bulk tanks on smaller farms, that's a real impact, isn't it, that you're going to have some milk that gets washed away, even though you measured it for purposes of determining how much the processor has to pay?

A I mean, theoretically, I can't answer that. I mean, my experience, and I had very practical experience in dealing with this on a day-to-day basis, it is a management issue more than it is anything else, and it's an attitudinal problem.

I mean, this testimony earlier today of, I can't remember, like three percent of something -- that .03 percent. I mean, if I had seen that, I would have just gone through the roof. We would be taking names.

Q We've heard actually that same number from both Land O'Lakes and Michigan Mill, right?

A And it's inexcusable. And the Department should not excuse it by giving them credit in the regulations. And the only way to do that is to

minimum price it on the full amount of milk, the plants knowing they're paying for that, they will demand the accountability and they will correct it, and it won't be a problem and we can move to the 21st Century from the 19th Century.

Q You're not proposing that we move to a system where it's plants weight that dictate how much the farmers get?

A No, I'm not.

Q Okay.

A But there are technologies that can be used, drip testing.

There are a number of things that can be done, and we are masking inefficiency in the system by relying upon this shrinkage and institutionalizing it in the system. And if they can't deliver all that they say, they shouldn't be paid for it. I would go with that, but there are ways to do it.

Q But that's what the shrinkage is supposed to address.

A I understand that. But what you're doing is, you're telling somebody you can have this amount of shrinkage, and they will have that amount of shrinkage. And I'm saying you can't have any

shrinkage, and if you do, you're going to pay for it. It will be taken care of.

Why should the producers who are taking care of it subsidize those who aren't?

Q Well, I would have assumed that a co-op whose milk is being delivered to their own plant would have every incentive to avoid unnecessary losses.

Would you agree with that?

A You would think so; but I don't know that.

Q Do you know whether milk is lost when a clean-in-place of the tanker is performed?

A You mean after the tanker has unloaded at the plant and they do the rinse?

I'm sure there are some milk and milk solids that are left in there, yes.

Q That goes down the drain, so to speak?

A Certainly should not be putting it into the silo.

Q Okay.

A But I can also tell you they developed a lot of techniques to get just about every drop of that out of there.

Q I have one point of clarification before I switch to another topic, which is on page 28 of

your testimony.

You make a statement at the bottom "the make allowances are a function of yield."

A Yes.

Q I want to make sure that you agree with me that the make allowance surveys -- start that again.

You would agree with me that the cost of production surveys that were used by the Department to set make allowances used actual plant yields to determine what the costs were per pound as opposed to assuming a formula yield?

A I would agree that they did not use the Van Slyke formula to compute it; yes, I would agree with that.

Q All right. Switch to a new topic. Fat retention in cheese.

A Yes.

Q You're proposing that the .90 assumed fat retention in cheese under the existing formulas be changed to .94, correct?

A That's correct.

Q And you have provided various data to support that change, correct?

A I have tried to come up with all the data that's

available because the Department has not done the survey of that.

Q Okay.

A Or anybody else on any broad scale.

Q Now, some of the data that you use, and I think it's actually the first part of the discussion on page 35 and it goes on, you have some California data, correct?

A Yes.

Q And although -- before I get to California data, you would agree with me that properly conducted, one can in fact determine what a plant's true experience is in terms of fat retention in cheese?

A Yes; I mean, that's in a way what I was trying to show with the methodology of Exhibits 34A, B, and C, is that you take all the total components that come in the door, and you measure what goes out on the dock, and you can do that, yes.

Q Those are hypotheticals, right?

A I said it's a "methodology." Yeah, I would agree with that and it needs to be done and that would certainly shorten this hearing tremendously if we had that data.

Q You would agree with me that you have come up

with rather roundabout methodologies to determine what in fact is a measurable fact?

A I think I said in one of the things that it seemed a long way to get to where I was going, yeah.

Q Now --

A But I believe what I got was a defensible number, and if we had the true numbers, it would be pretty close.

Q Now, going back to where I was a minute ago. The one place you tried to look for some information was some California data, correct?

A CDFA, yes.

Q Yes. Now, you are ultimately trying to apply the Van Slyke formula to that data, right?

A It's a standard used formula, yes.

Q Let me put up the formula.

A Can you move it over.

JUDGE PALMER: I think we need the screen moved.

Q Can you see that?

JUDGE PALMER: Can we get his attorney perhaps to help.

A I can see it. He had filled up the screen and words were missing.

Q Okay.

JUDGE PALMER: Okay.

Q I have simply -- and feel free to compare. I'm not asking you this from memory.

A It looks like the formula.

Q On page 30 you have set forth the formula.

A I would accept that.

Q And there's no trick to this.

A No, I would accept that.

Q What I want to do is get an understanding as to what it was you knew and didn't know based upon the California data --

A Okay.

Q -- that you reference.

Now, the Van Slyke formula, one use of the Van Slyke formula, of course, is to put in a certain number of inputs and determine from that what your yield of cheese should be, correct?

A That's right.

Q And you were trying to do something a little different, namely, you were taking cheese yields and trying to back into what the butterfat recovered was to have produced those pounds of cheese, correct?

A Which if you have -- what you're trying to solve

if you have that and there's another and you don't, you should able to just rearrange the algebra.

Q Now, let's take as an example just so we know what data you had and didn't have. Let's look at page 37 of your document.

A Okay.

Q Make sure I have the right reference here. One moment. Page 36.

You had some data for calendar year 2005, correct?

A From CDFA.

Q From CDFA.

A Yes, I did; as we all did. It's part of the record.

Q Right. Now, let's see what that allowed you to know and what it didn't allow you to know in terms of doing the Van Slyke formula.

A Okay.

Q You knew that weighted average yield of cheese was 11.89 pounds, correct?

A Right.

Q And so that allowed you to fill in the pound of cheese number; is that right?

A That's absolutely right.

Q And then you knew the butterfat pounds, correct?
A Yeah, we were given butterfat in the vat, that's right?
Q And that was 4.35 pounds?
A For what year?
Q 2005.
A You're using the one for all cheeses, okay, yes.
Q And then you knew the moisture in the cheese?
A Right.
Q 37.22?
A Right.
Q But you didn't know what the percent Casein in protein was; is that right?
A I assumed the percent Casein in protein.
Q They didn't tell you this and didn't tell you how many pounds of protein there was in milk?
A Yes, they did. The CDFA data provided sufficient information that you could approximate the amount of protein in the milk.
Q We'll get to that in a second. You don't have that here, do you, in your description of the data?
A No; it was not posted there, no.
Q Now, let's talk about, then, how you tried to fill in those two.

A Okay.
Q Now, for protein pounds, the way you tried to arrive at that is, if I understand your math, you would have divided the 4.35 pounds of butterfat by 1.17; is that right?
A There are -- to get to the protein in that milk, there are several ways that you can get to it; one of which is assuming that it's producer milk, entirely producer milk.
Q Right.
A And no fortification and no UF'ing or anything to get to the vat. Then you could say that the protein is -- the butterfat based on the DHIA test was 1.17 times the amount of protein.

That's one way to do it.

Q Just to clarify, that is a number that you derive simply by looking at the ratio of butterfat to protein in California milk cows on average, correct?
A Right. Which should be what they're getting in the California milk plant.
Q And then --
A On those kinds of volumes, it should be very close.
Q Okay. Now, one possibility, of course, is

that -- and by the way, you confirm that these measurements are vat measurements, correct?

A Yes.

Q And you so state it?

A I wanted to make sure that that's in fact what we were talking about. I thought that's what it was, but I wanted to make sure.

Q And then, to get the other piece, the percent Casein --

A Yes.

Q -- you multiplied the pounds of protein times what, the Casein-to-protein ratio that we've been talking about?

A I used the existing 82.2 percent.

Q Now, as a matter of mathematics under the formula, as the ratio of butterfat-to-protein goes down, the butterfat recovery in cheese needed to produce 11.89 pounds of cheese goes down, correct?

A I'm sorry, state that again.

Q Yes. Well, the more Casein -- well, yes, as the ratio of butterfat-to-protein goes down, the butterfat recovery in cheese needed to achieve the designated yield goes down?

A I'm not sure.

Q Okay.
A I haven't thought of it that way.
Q All right. How about this, then: The more pounds of protein that are in the vat relative to the pounds of butterfat in the vat, the lower butterfat recovery you need to achieve the designated yields.
A Well, I think it's true that the more -- again, I want to withdraw that. I don't know.

I just haven't thought of it in that concept; and I'm sorry, but I don't think of it that way. I mean, obviously the more of one thing can change the yields, but I -- I guess in doing your formula -- let me answer it this way, and I think this is what you're asking: Because we're solving -- we know what the pounds of cheese is, so we're trying to solve what the butterfat recovery is.

Q Right.
A It is safe to say that if the pounds of cheese that comes from the protein goes up, then the pounds of cheese that comes from the butterfat goes down; and if the percentage of butterfat is static, then your butterfat recovery would go down.

Q Okay. Great. So that if you maintain the 4.35 butterfat pounds that you knew from CDFA was the number, but you increase the number of pounds of protein beyond that, which appears in milk that comes straight from a California cow, then your butterfat recovery percentage can go down and you'll still achieve the 11.89 pounds of cheese.

A Yeah, theoretically; you may be right. It wasn't how I was looking at it.

Q Well, for example, if you were to fortify the vat with nonfat dry milk, that would increase the protein and increase the Casein, correct?

A Yes, and I would anticipate that that is exactly what's going on in plants.

Q And that would reduce the butterfat-to-Casein ratio, correct?

A The more Casein would reduce, that may be.

Q By definition, if you put more --

A That's right; the more you fortify it, the ratio --

Q The ratio is going to go down?

A Right.

Q And the result is that by engaging in that fortification, you have reduced the butterfat recovery rate necessary to achieve 11.89 pounds

of cheese, correct?

A To a point. Once you reach a certain point when there's not enough -- if the ratio is off and you don't have enough butterfat to really efficiently use all the protein either.

I'm not a chemist or anything, but there is a range in which it works -- the Van Slyke formula works, and there's a range where it doesn't work.

Q And in fact, you assume there is such fortification going on in these California plants, aren't you?

A I think that in a modern -- yes, I assumed that; and I think that was a proper assumption to look at, that there was fortification.

Q And if you fortify using condensed skim, the impact is the same, right; you're not adding any fat, but you are adding protein and thereby adding Casein, and you're reducing the butterfat recovery percentage necessary in order to achieve that 11.89 pounds of yield, correct?

A Well, I'm not going to say you're not adding any fat; you're not adding a lot of fat as a percentage of the solids -- the nonfat solids that you're adding.

Q Okay.
A Unlike UF milk or something like that, in which case your fat removal is almost total.
Q All right. And that was really my next example. If you're adding UF skim concentrate, once again, that's essentially liquid protein, right?
A Yes, it's a milk protein concentrate, absolutely.
Q If you were to add that to the vat, then you would have a much lower butterfat-to-Casein ratio than in former milk, correct?
A Right. I mean, the value, that's true. Whatever that protein value is will effect what you come up with a result for your butterfat recovery.
Q And the bottom line is, the more fortification that you've engaged in, in California, with respect to either nonfat dry milk or condensed skim or UF skim, the more of that you've done, the lower your butterfat recovery needs to be in the Van Slyke formula and still be able to achieve 11.89 pounds that we know California plants are producing?
A For that particular time. But see, I think you can pretty well tell, because by and large the

milk that's in that comes from some very large modern well-run plants; that was an assumption that I made.

And the common -- a cheese maker can argue with me and they know more than I do. But the standard number used in Casein-to-fat ratio is .70 for a cheddar plant. They gave us crude protein. And using that as a basis and 78 percent of crude protein being Casein, one can, I think, fairly accurately estimate the protein level in the vats of a modern California cheese plant based on the information given. And from that, determine what the butterfat recovery is.

And I would further state that any error that I would have made probably overstated the amount of Casein and reduced the butterfat recovery that was derived.

Q But you didn't have any direct information, I take it, as to how much protein was actually in those vats, correct?

A Didn't have any direct, but you had -- yes, you did; you had the amount of solids not fat, but really what you had was the amount of butterfat. And with the amount of butterfat in a modern

cheddar cheese plant, you can come pretty close to saying it's going to be in that range if you're going to produce the kind of commodity block cheese you're doing because that number is pretty well established in the industry.

Q What exact assumptions are you making?

A The first assumption to come up with this was a 78 percent of recovery of Casein in crude protein.

And the second assumption is, is that your Casein-to-fat ratio will be .70; .70, so that if you took the Casein and divided it by the fat, you would have a ratio of .70.

Another way, I didn't do it directly, kind of approximated, another one is you can do a fat dry matter basis for cheddar and there are tables out there that suggest -- and I'm little tired, I don't have it in front of me, but it's in the low 50 percent, 50-some percent, depending on whether you're making a full fat or whatever. And from that, using those same numbers, come up with the amount of protein sufficient enough to estimate the butterfat recovery in those vats.

And then there's another assumption I made,

and the other assumption is, which is very common today, is that the plants -- and I think California shows it, I think California is a protein-deficit milk supply that they have to fortify the milk, okay, so you can assume they used all of the producer butterfat, and that they standardized to get the full cheese that they could for the fat that was recovered.

That was another assumption I made.

Q If you added protein-rich materials, as you've described, this would not show up as a Class IV(b) usage for California purposes, correct?

A Doesn't make any difference for what I'm doing.

Q Is that correct?

A Yes.

Q Doesn't show up in those?

A I don't know. You know, I know more about California than I want to at times. I don't know fully how they classify nonfat solids going into the IV(b), I don't know.

I would assume that they price it at the -- I'm almost positive priced at the IV(a) price because that's one of the advantages. You get to bring in the IV(a) price, which is a much cheaper price per pound of protein than what you

pay for the IV(b) price because that's also one of those economic arbitrages that go into whether you're going to fortify or not.

Q You make reference to using the RBCS study on page 39.

A That's right.

Q Now, if I understand your approach there, you were assuming, and you said you can derive 95.25 percent butterfat recovery; is that right?

A That's what I estimated, yes.

Q But that assumes that the vat includes butterfat and true protein?

A At test.

Q At FMO average test, right?

A That's all that I had at that point. I didn't have any vat tests.

Q All right. So to the extent that the vats for the cheese plants that were covered by the RBCS study had different amounts of butterfat or true protein than simply the averages for all the milk cows in the country, you wouldn't know what the butterfat recovery rate was?

A I would agree. It's an approximation. We don't have the information. I think it should have been in the information. I mean one of the

contentions that we make if you're going to ask plants how much it cost to produce cheese, you ought to tell us how much cheese you're getting out of the milk that you're going to price.

If we had that information, we could do something with it and I wouldn't have to come at it in the roundabout manner that I did.

Q And --

A By the way, there's been other testimony in the last three or four days that have substantiated that these numbers are not far off.

Q Well, I didn't hear it that way. But in any event, why don't we go to New Mexico, since that's the next data point that you provide on page 40.

A Right.

Q Do I understand correctly that in deriving from the New Mexico data butterfat recovery of 93.4, you're assuming that the vats contained the exact same components as came out of the average cow in new Mexico?

A Right, that's the information that I had.

Q And to the extent that there was -- okay.

And to the extent that there was fortification or UF'ing or anything else going

on, those numbers would not be right?
A If I had more information, I could have a more accurate number.
Q And on page 41, you make a statement there that "Finally a comparison FMMO average test on all producer milk and FMMO test for milk that goes in the Class III shows that virtually all butterfat from producer remains in cheese effectively 100 percent butterfat recovery."

But, first of all, I mean, if the butterfat went into whey cream, it would show up as a Class III product, right?
A My understanding is if it's sold as whey butter, it would have to be treated as Class II.

You know, I --
Q If it's sold as whey -- are you saying the sale of whey cream is Class --
A It's butter. It's a Class IV butter product that competes with butter in some markets.
Q So that statement is based upon the supposition that any of the butterfat from a cheese plant that went into whey cream and was sold does not appear -- is not treated as a Class III usage.

Is that what you're saying?
A I mean, if they're making a product that's not

cheese, I would assume that it's going to be treated as Class IV.

I have not been able to verify. It's a small amount of product.

Q But to the extent that there's losses in the process, because of the fines or because of the cleaning, et cetera, that would all be treated as milk going in the Class III usage, right?

A I would assume so. I think that would probably be the correct statement.

Q From a Federal Order perspective.

A I think that would be contract.

Q As opposed to actually ending up in the cheese; is that right?

A Well, it ends up in the cheese; that's just a byproduct of making cheese.

Q Well, it's not literally in the cheese.

A It's not literally in the cheese that you buy at the store and eat, no. You're going to get it.

Q Well, what do you mean by that?

A If I buy a banana, I eat the banana, I'm going to have a skin, right? If I make cheese, I'm going to have fines.

One has to assume if you got a loaf of cheese in the deli counter, that there were some

fines back in the back. How many of those got into the cheese, I don't know; that's just the process.

We sell milk and all that milk is not going to go into the cheese.

Q Okay. All that butterfat will not go into the cheese?

A All that butterfat is not going into the cheese, and I never said it really would.

That's why we're suggesting 94 percent. If I asked for 100 percent, then I think you might have an issue.

Q I was just focusing on that one paragraph where you said that "Virtually all butterfat from producer remains in cheese."

A Well, I guess "remain in the cheese" probably was not the way to say it.

Q Okay.

A But it remains as part of the cheese-making process. And if you didn't have all of that butterfat, you would not have as much cheese as is being produced.

Q And in this context, to say it remains in the cheese-making process, would include butterfat that ends up in sweet whey or washed down the

drain as part of cleaning processing, et cetera?
A Right.
MR. ROSENBAUM: That's all I have for now.
JUDGE PALMER: Fine. Thank you.
Questions?
How about over there, Mr. Schaefer, you have a question?
CROSS-EXAMINATION,
QUESTIONS BY MR. HENRY H. SCHAEFER:
Q Good afternoon, Ben.
A Good afternoon.
Q Rapidly approaching suppertime.
A Suppertime, yes. And I apologize for eating, but I have to have a certain amount in me.
Q That's fine. With regard to the questions that Mr. Rosenbaum was just asking and you drew that information from table -- your table CC, which was table "Butterfat Test of Milk Used in Class III," are you aware that the butterfat test represented in that table reflect the butterfat test of the milk allocated in Class III and do not necessarily represent what may have gone to plants?
A There may be, and it was a fine point at the end that I wanted to -- I wish I had spent more time

to, verify, part of it being a little concerned with ex parte. It's my understanding, though, if it was sold as a butter product, that it could be treated as Class IV.

Also let me say this: There is the difference in the Class IV and the Class III butterfat price doesn't make any difference how you classify it.

Q Let me rephrase the question a little bit.

In that when the allocation process occurs in a Federal Order pool and producer milk is allocated, the allocation does not necessarily reflect where that product physically went; the allocation is a process by which we classify milk, but it is not necessarily saying that if it was allocated to Class III, that it went into a cheese plant.

A It went into cheese.

Q I guess I'll phrase it this way and you can agree or disagree: It may be such things, depending on the month and lowest price class and so forth, that number may also include inventories, it may include shrinkage and so forth and so on that occurs in the federal allocation process.

A Right, I would assume that there's a -- yes, I understand that if you had even 100 percent Class I bottling plant will have some Class III, depending if it's the lowest price based on shrinkage. I understand that that would get in there.

But what struck me was -- because obviously the bulk of the Class III utilization is not being drain at bottling plants, I mean, it's coming out in cheese. What strikes me is the fact that the amount of butterfat that we have on the producer side and the amount that shows up in the Class III is almost identical, and you don't see that in any of the other classifications.

Q I believe you answered Mr. Rosenbaum's question on whey butter, that it should show up in Class IV.

A I mean, that would be my -- if you make butter at a cheese plant, I've got to believe that it's going to be treated as a Class IV product.

But, I mean, that's -- you guys know that. I am not up here to tell you guys how you do your job.

JUDGE PALMER: You want to ask him a very

leading question, he wouldn't mind.

A If you want to tell me how it is and shake your head yes, I'll say yes.

Q Okay. Let's do it this way, then, Ben; it's been suggested to ask it this way: Are you aware that when milk goes into Class III into a cheese plant and the cheese plant basically makes only cheese, we don't have ice cream, we don't have any of those kinds of things, that the Federal Order treats that as a Class III usage of milk; and that the byproducts that come off of the vat are still considered Class III. So, for instance, let's pick on dry whey, dry whey is not reclassified to Class IV, even though a dry product, it stays as Class III.

A Then my assumption under that comparison with table CC, I guess, is not an assumption that should be made then.

Q Change of topic a little bit. You had mentioned when we first started out, I believe Mr. Miltner said if there were any changes in your testimony, that you had read something incorrectly, that to go directly to your testimony and that would be the correct value to use.

A I think -- I mean, I -- somehow in the back of my mind I think I changed something as I was reading it, but I can't remember what it was.
Q One of the things that I noticed is on page 12.
A Okay.
Q And in the second paragraph, the paragraph starts out the second table in document KK comparison class prices. You have 5.8 percent other solids there.

I believe when you go back to KK and then look at the table right before that, when you're looking at your standard test milk, you were using 5.6935.

A It's what's in the -- it's what in JJ, not what's in the testimony. I mean, JJ -- I can tell you what's in JJ shows up in KK because that spreadsheet went out and grabbed that number, it didn't look at my testimony.
Q So the 5.8 should really be 5.6935?
A Yes.
Q I guess just to clarify a little farther at the beginning of your cross here, when Mr. Miltner was talking about what was said and what's in the document. The one I was referring to was printed there, and so but you were looking at it

the other way. So, for instance, in another example where I believe you might have said 1.7, and the document says 1.17 with regard to the fat-to-true-protein test, you would have meant the 1.17; is that correct?

A Right, right.

Q Okay.

A We tried our best to go through and jive the numbers, but it was a monumental task.

MR. SCHAEFER: Thank you, Ben.

A Thank you. Thank you, for giving us, by the way, the opportunity to present some of these proposals. We appreciate that very much.

JUDGE PALMER: Mr. Vetne wants to ask a few questions.

CROSS-EXAMINATION,

QUESTIONS BY MR. JOHN H. VETNE:

Q Mr. Yale, good afternoon.

A Mr. Vetne, good evening.

Q Okay. In various portions of your testimony you refer to calculations, many of them dealing with adjustments of yields or shrinkage, et cetera, et cetera.

A Right.

Q And with respect to each component of your

aggregate proposal, or proposals, you attach a number which you indicate is lost revenue to producers, for example, page 13.

A Right.

Q 13,000 --

A Compared to the current formula.

Q Page -- 31,000 page 24, page 27, ending up at page 50 if all of your proposals were adopted, there would be a $14,868 gain to producers?

A Right. All of those are more detailed in the various exhibits that are referenced.

Q You're not suggesting, are you, that producers are not now getting some of the money that you indicate is now being lost to them; you're simply suggesting that this is revenue that does not appear in the regulated blend price?

A You know, I think I really am suggesting that, maybe not in the exact amounts. And I'll tell you why, is although this position I think in time, in large part because what's going on may change, but there is an institutional use of selling manufactured grade milk -- not grade milk, milk for use in manufacturing at the Federal Order class price plus or minus a number, okay? And that their exists in the

various markets, whether in the Northeast or the Southeast or the Southwest, or whatever, a fairly consistent -- although it may be seasonal -- but a fairly predictive basis off of that three or four reference price.

And my experience has been, at least over the last seven years, that when the Federal Order price changed, the reference -- or the basis didn't.

So does that mean at some point the market will start to make it up in terms of some additional premiums or something, you know? I've got to believe that somewhere along the line that may happen, but by and large what I've observed, that if you have a contract, say, for, example, Class III plus $0.30 FOB the plant, then tomorrow the Federal Order program announces a new Class III formula price, that it's still Class III plus $0.30 -- or $0.35.

So to answer your question, I mean, I just wanted to explain it; that's why I believe that.

Q You have produced a mass of documents and a long piece of testimony, but not one page or one paragraph in that evidence that you have proffered contains any objective fact supporting

the opinion that you just drew.
A I didn't state that, but I think that we had --
Q Am I correct?
A You're correct. And I intentionally didn't state that in there.
Q But in order to know whether what you term "losses" in about 10 or 15 places in your testimony, which are changes in regulated prices, whether that revenue, if it exists, is not flowing to producers, you would have to go to the individual handlers' financial information, look at the revenue and look at the flow of that revenue through the system to producers, correct?
A I mean, there would be a way that you could do it. You could do an analysis that could show you exactly, then you might be able to plot out and say this month the price changed from last month, then you can isolate what those changes are.

Absolutely you can --

Q I'm not talking about prices here. Let's look at revenue. In many places you suggest that processors or manufacturers are making revenue that producers do not see.

Am I correct about that?

A Yeah, I think the way that milk is priced today, it's sold on a class price basis, and I'm not aware of any contracts that adjust -- that the class stream doesn't adjust whether or not the make allowances or whatever --

Q Let's get back to my question.

A Okay.

Q You're talking about prices and how products are priced.

I'm talking about the revenue that flows from whatever those prices are. Please, in your mind, try to get away from how the prices are set.

A Let's look at gross dollars because that's what we spend.

Q Whatever those dollars are. So if a plant that is getting marginally more yield on cheese or powder, whatever, a plant is getting marginally more yield and, therefore, sees a little bit of extra revenue.

Your suggestion is that if that can be done, it ought to be put into the formula; basically, attribute to everybody more efficiency and charge them for it.

A We're suggesting to add an average, the weighted average is what we're trying to approach.
Q But that's the trend of your --
A That's the trend of what we're saying, yes. One way of saying it is we are allocating the value of the finished product to the producers at a higher rate than the current formulas.
Q So my question relates to, we're at a point now where there is revenue in the system, and it's not getting into the formula.

My question related to whether that revenue flow is now getting to producers.

Now let me start with this group, with respect to, for example, powder, that is manufactured predominantly by producer groups, all of that revenue flows back to dairy farmers in the form of pay price or equity. Those organizations are 100 percent owned by producers and all of the revenue goes to the owners, correct, in some form or another?
A Not necessarily the producing owners or members.

And I don't want to get into a discussion how money moves from co-ops or producers because it's not as efficient as you're suggesting.
Q It is, nevertheless, producer money and it flows

to producers. Now maybe some of it goes into salaries of their managers, but it is -- the co-op is the producer for Federal Order purposes, correct?

A Yes, I mean, the co-op receives that benefit. Whether it ends up in the hands of the members who are producing that milk, that's where I would have the disagreement.

Q Yeah. And that depends on how the co-op management, the board, decides to allocate that money, retain the money, whatever?

A And you've got a sizable -- some of the older co-ops, a sizable amount of retired members that have equity that will receive that money instead of the producing members.

Q Which is part of their agreement?

A Part of their agreement, absolutely.

Q It's a board of dairy farmers that make those decision for every co-op?

A Is that a question?

Q Correct?

A I would hope so; that's what the law requires.

Q All right. With respect to -- so whatever extra revenue there might be that is not currently in the formula but is in the system with respect to

nonfat dry milk, the vast majority goes to the producer?

A See, it goes to the co-op who stands in the shoes of the producer in those situations. I don't know that it goes to the producer and it doesn't go equitably to all producers. It goes to the producers who happen to be members or owners of co-ops that have Class IV plants and not all producers in the United States are members or producers and co-ops that have Class IV plants; and those that are, are not necessarily in a proportion to what Class IV milk that they have a reduced blend price.

Q So your philosophy is that if there is additional revenue in the system flowing from the sell of powder but it's not in the formula, it should be in the formula so that all producers can share in it?

A That's right.

Q Okay. Why not do the same thing for Class I?

There is additional revenue in the system in the form of Class I premiums that are not being shared with all producers to be consistent, why not do it for Class I and Class II?

A Are you suggesting that the cost to move milk into a bottling plant in Atlanta, Georgia ought to be distributed amongst producers in Seattle, Washington?

Q No, I'm suggesting that the revenue after cost -- you have a cost factor and you have a revenue factor. I'm suggesting why not have the Department look at the revenue produced outside of the regulated system currently and redistribute all of it in all classes?

A Well, you know, you've got to look at what the revenue is.

Q Exactly.

A All right. And I think the comparison between the revenue the Class I plants are paying and what the revenue that I'm talking about in Class IV are two different things.

I'm not asking the Class IV plant to pay to move the milk to the plant. I'm not asking the Class IV plant to balance my plant. I'm not asking the Class IV plant to provide any of the other things that are associated with the supply of milk to the bottled market, okay?

So I can't -- I cannot buy into the comparison; and, frankly, John, I think that if

you get me started on the Class I pricing, particularly in the Southeast, it's irrelevant to this hearing and we do not have enough time before the hearing's over with to cover it.

Q Let me take the pages to which I've referred before --

A Okay.

Q -- with additional revenue.

With respect to all of those pages that apply to either adjusting yields, shrinkage, losses, I think you said that you are assuming a -- you don't have a plant that has all of those components of your proposal, but you're assuming hypothetical efficiency that's available for all stages of production?

A Right.

Q Are you familiar with what's been marked Exhibit 10, and I don't have a copy right in front of me, but it's the State of California cost of manufacturing survey.

A Right.

Q And they have a column, they have groupings of high cost plants and low cost plants.

A Right.

Q Then they have a column that shows ranges with

respect to each line item of cost.

A Right.

Q A low cost range and a high cost range.

A Lot of nice information.

Q You're familiar with that column?

A Oh, yes; I looked at it.

Q That column. Your hypothetical or idealized plant would that be something like or serve a function similar to taking the column of low cost among the plants, adding them up and using that as a make allowance?

A No; my view is to find a weighted average plant at this point. I think to do anything differently starts to be something that goes from what could be argued as an objective to something that can be very arbitrary.

And I think there's a long tradition, particularly in the CCC program, that used make allowances before where we're at today, they used to talked about an average plant of average efficiency; and I think that that's got to be the target. Frankly, I think that it would benefit everybody if it moved on the higher, including the other plants. But I don't need to go there. We're satisfied with the average,

whatever that number is, and unfortunately we don't have all the averages we would like.

Q Now with respect to yields, let's go to cheese, for example. With respect to cheese, if you have a cheese plant that shows a yield of -- let's even all cheese plants. Let's say all cheese plants show a yield of 10 1/2 pounds of cheese.

A Okay.

Q Produced from the contents of the fat.

A All right.

Q Is it your suggestion to use that 10 1/2 pounds in the formula?

A If that was the average. Well, depends, yes, I would expect that 10 1/2 to show up in the formula depending on how it would work with the protein and the butterfat. I mean, how that would -- how you would allocate between them I would need more information.

Q You would have to adjust, would you not, that 10 1/2 pounds for added nonfat solids and added butterfat to the fat that is different from the incoming producer milk?

A I assumed that the plant that you were talking about, that that was based upon producer milk.

Q All I said was vat. You are aware --
A I mean, if you're going to get into the vats, then the range can be all over the place because we just don't know, are they standardizing to the protein, are they standardizing to the fat, what is their, you know, fat content in terms of dry moisture, or I mean, all of those things start to play in there.

I don't know that you can look at that. I was just thinking of a simple -- I thought you were doing a simple thing.

Q Well, I was looking at the vat. It's common that in California solids are added to the vat to fortify protein.
A I would say that most modern cheese plants today on a normal basis are doing it, although with this high -- I mean, like I said earlier this week, why do it.
Q It's a common practice among some plants?
A Right.
Q And we heard testimony earlier that there's a practice of adding cream.
A Right. Well, yeah, there is, although it depends on -- it depends on what you're mixing and where you're trying to go.

Q My point is, you can't take the yield at a plant and apply it to producer milk, you have to make some adjustment and you have to know, in order to make that adjustment, what are the added solids?

A Well, the answer to that is what I was suggesting with Exhibit 34, is that my A, B, and C is that you have this methodology that looks at all of that so that we can begin to get a feel for how that goes.

THE WITNESS: Your Honor, can I have a short break?

JUDGE PALMER: You know what I'm going to do? I want to --

THE WITNESS: I feel strong answering the questions, I just need about a two-minute, five-minute break.

JUDGE PALMER: I'm wondering if we ought to shut down a bit.

THE WITNESS: I guess we're going to shut down.

MR. VETNE: I'm going to be maybe 15 minutes.

JUDGE PALMER: Oh, you're going to be 15. Does anybody else have questions? You do?

They have.

MR. ROSENBAUM: Your Honor, I guess I would urge that we try to finish, assuming Mr. Yale is all right with that.

JUDGE PALMER: Let's take a five-minute break.

(A recess was taken.)

JUDGE PALMER: We're going to resume. Had a break.

Go ahead, Mr. Vetne.

BY MR. VETNE:

Q So we were talking about plants, Mr. Yale, that acquire solids, cream, for example, skim condensed, UF milk, or powder, some form of solids to add to the vat to help the efficiency of their system, all right?

A Okay.

Q You agree that that happens?

A There's no question.

Q In fact, Select sold UF milk for that purposes?

A I think I testified to that.

Q In order to convert that to a producer price, you have to make some adjustment for the difference in yield with those added solids and try to figure out what the yield might be

without added solids?
A I don't know -- you, Mr. Vetne, I don't know that I agree to that. You're adding a level of complexity of trying to understand what needs to be done. If you want to testify or somebody testify, that's fine. I don't buy that. I don't understand that. I don't think that way.
I'm not going to be able to answer that kind of a question.
Q Okay.
A So, I mean, to me, the fact that a plant adds other ingredients to add value to the producer milk is part of the function of determining what that milk is worth that the farmer ought to receive.
Q Okay. That plant, if it produces 10 1/2 pounds of cheese, for example --
A Okay.
Q -- you cannot fairly attribute 10 1/2 pounds of cheese to the incoming producer milk; you have to attribute 10 1/2 pounds of cheese to the producer milk, as well as the added solids.
A And I don't necessarily buy that and I --
Q All right.
A And I think it's a level of complexity that is

beyond quantifying to be able to come up with any kind of yield or anything else.

Q Now, an additional factor for plants that buy UF milk or condensed milk, or who knows, condense they're own or UF their own milk to add solids, there's a cost to creating those solids, whether they're in wet form or dry form.

A Okay.

Q Agreed?

A Yes, I agree.

Q There's a cost of taking water out of milk -- out of skim milk.

So those plants, either in the purchase price of the solids, or in the process of creating those condensed solids is going to have a cost that a manufacturer that just receives milk without fortification is going to have a cost that the other plant doesn't have.

A But they would take that cost if they felt that it gave them a greater yield.

Q Right.

A Not yield in terms of cheese, but a greater return on their investment.

Q And --

A Which means the milk that they bought is more

valuable. Because without that milk, it makes no difference whether they buy the fortification.

Q And that, in fact, is a practice of California plants and other western plants to incur those costs of converting skim milk to condensed or powdered milk, or taking cream that's been separated with a cost.

A I'm sure.

Q You've suggested that you shouldn't adjust for the added yield from added solids.

Are you suggesting also that the additional costs associated with doing that should not be included; is that a reason for excluding the higher cost plants in the West Coast?

A No, that's not what I'm saying. What I'm saying is very simple, is that however the plants do it, all right, whether they have an open vat or a closed vat, or it's horizontal and it looks like by binoculars or a vertical vat, you know, whether they include the whey, don't include the whey, the point of it is if on the average the milk that comes in from the farm at the front of the silo and amount of cheese that goes out the dock, whatever that yield is, that's what we're

going to use.

However the plant got there, whether they added, you know, solids or cream or dust, I don't care. What we need to be looking at is how do we get there? That's what I was trying to get us to look at a bigger thing like 34A, rather than getting down focused on this minutia of whether the ratio of purchase solids versus acquired solids for milk is this, or we buy cream or anything. It doesn't get us anywhere.

That producer milk, based on whatever technology the plant uses, whatever products it buys to make it work, a pound of producer milk going in that plants is going to yield so much cheese at the other end, and that's what counts. If they buy solids, who cares.

But, let me say this, two things about that: First of all, the make allowance that the producers -- income is reduced, includes all of the equipment, management, payroll, packaging, everything else that's ascribed to all of those things that are done, number one. And number two, a plant is not going to acquire this additional product unless it's of value to them, and that makes -- that means that the milk is

worth that to him to do so.
Q Okay. Would you agree with the economic premise that in a market system, businessmen, including cheese makers, do what they can to maximize profits, including increasing prices whenever it's possible and reducing costs whenever possible?
A Aside from I can't remember the economist that believes that we reach an age where we want to induce risk because it's more fun, I have to assume that businessmen think efficiently and maximize profits.
Q So you would agree with that?
A I think that you would have to assume that.
Q All right. My point here in the prior question with respect to additional costs of plants that receive solids, that is a practice in California. California plants have higher costs, and for reasons of higher costs you suggest that USDA not look at California plants; is that correct?
A My reason is that they don't look at California plants because they don't represent what's going on in the Federal Order program. They're not in our -- they're not in the milk-buying market,

they're in the cheese market, and that's reflected in the CME and we get that kick.

But they're not in the milk-buying market that has an influence on what the price of milk is and, therefore, should not be reflective in the manufacturing cost or even their NASS prices.

Q Okay. Well the manufacturing costs are not a factor of either the price of milk or the price that a product is sold for; it is what happens in between, correct?

A I guess.

Q And you have suggested, have you not, that the Secretary should look at the efficiency of Western plants, and with all that new equipment, as to what ought to be attributed to plants to the east of California, so that they can achieve additional revenue from lower fat losses, higher yields, et cetera, et cetera?

A I mean, all the plants that are within -- that are part of the Federal Order market, I think, you know, ought to be included either completely or representatively, and -- but we don't believe that the California -- we don't think that it -- it doesn't -- we don't get all the other

benefits out of it.

Q Are you not seeking to attribute to Eastern plants some hypothetical efficiencies that are currently achieved in California without allowing those Eastern plants to recover the additional costs that are also incurred by California?

A I would give you that if you took out the California costs, then maybe looking at their yields may not be relevant, if we had the information of yields in the rest of the market.

But I would also believe, based on the testimony that's been given here, and other things that have been said, that that 92, 93, 94 percent is not unrealistic, even in these Eastern markets at a modern cheese plant today.

Q "Not unrealistic" meaning hypothetically?

A I think there's been testimony that certainly suggested numbers in that range.

Q Of a plant that only receives producer milk and receives it seasonably with seasonable variation?

A As I said before, I don't care what they do with it when it goes in the door, that's what that milk is worth. If we didn't deliver them that

milk, they wouldn't be able to make that cheese. If they have to get something to make it more valuable, that's fine, but that's our milk and we ought to be paid for it.

Q So if they have to add something, they eat that portion; that's not legitimate cost -- legitimate costs?

A If their cost to add that were higher than the price of the raw milk that they're buying, they'd buy more raw milk.

Q Excuse me, haven't we established that raw milk sometimes is not of ideal composition?

A They would buy the milk and UF it, whatever, and make the cheese if they needed to.

So they buy the powder because it's cheaper than buying the milk from the producers and using the milk.

Q All right.

A So, no, I think that we, you know, that we should get the full value.

Q Okay. So a plant that doesn't -- that receives milk that is of not ideal Casein-to-fat ratio, one option of such a plant, I think you were suggesting, is that they buy producer milk, UF it, convert the skim to a concentrate or powder,

sell off excess cream when it's necessary, introduce that into the vat, and they can do that without buying outside solids.

Is that what you're suggesting.

A Yeah, it could be done. And if the economics were that way, they would do it.

Q Are you also suggesting that whatever the cost of that plant to go through that process should not be included in the manufacturing market between the price received for cheese and the price paid for milk?

A No, you're paying for the management, the labor, the equipment to do it. There's an arbitrage between the raw milk product and the other components that you're talking about, and the fact is, is that you know, that's our milk they're converting and that's what it's worth.

MR. VETNE: That's all I have for the moment.

JUDGE PALMER: We're going to shut down now. We'll see everybody tomorrow morning at 9:00 and I want to find out what we have here in witnesses, though, and further the situation.

Let's go off the record for a moment.

(A discussion was held off the record.)

(Thereupon, the hearing was adjourned at 6:25 p.m.)