USDA - FEDERAL MILK ORDER HEARING

Sheraton Hotel Station Square
300 West Station Square Drive
Grand Station Ballroom I
Pittsburgh, PA 15219

Tuesday, December 12, 2006
9:15 a.m.

BEFORE: VICTOR W. PALMER
U.S. ADMINISTRATIVE LAW JUDGE

TRANSCRIPT OF PROCEEDINGS

VOLUME II

Reported by:

Monica R. Chandler
Professional Court
Reporter

APPEARANCES:

U.S. Department of Agriculture:	Office of the General Counsel by Garret B. Stevens, Deputy Assistant General Counsel, and William Richmond
U.S. Department of Agricultural Marketing Specialists:	Gino M. Tosi Jill Hoover
Dairymens Marketing Cooperative Association, Inc., Dairy Farmers of America, and Association of Dairy Cooperatives in the Northeast:	Marvin Beshore, Esq.
Select Milk Producers, Inc., and Continental Dairy Products, Inc., and Dairy Producers New Mexico:	Yale Law Firm by Benjamin F. Yale, Esq., and Kristine H. Reed, Esq.
O-AT-KA Milk Products Corp.:	Upstate Niagara Cooperative, Inc. by Timothy R. Harner, General Counsel
Nathional Milk Producers Federation:	Roger Cryan, Ph.D., And Kevin J. Brosch, Esq.
Agri-Mark Dairy Cooperative and Association of Dairy Cooperatives of the Northeast:	Robert D. Wellington
Lanco-Pennland Milk Producers:	Crossland & Speis, LLC by Edward C. Crossland Esq.
South Berlin Cooperative of New York:	Ken Dibbell

APPEARANCES (CONT.):

International Dairy Foods Association:	Covington & Burling, LLP by Steven J. Rosenbaum, Esq.
Prairie Farms Dairy, Inc.:	Gary Lee
Lamers Dairy:	Richard Lamers
Mid-West Dairymens Company:	Dennis Tonak
University of Wisconsin:	Brian Gould
Alto Dairy Cooperative; Associated Milk Producers, Inc.; Bongards Cooperative Creamery; Burnett Dairy Cooperative; Ellsworth Dairy Cooperative; Family Dairies USA; First District Association; Manatowoc Milk Producers Association; Mid-West Dairy Coalition; Mid-West Dairymens Cooperative; Milwaukee Cooperative Milk Producers; Prairie Farms Dairy, Inc.; Wisconsin Farm Bureau; Wisconsin Department of Agriculture, Trade & Consumer Protection:	John H. Vetne, Esq.

I N D E X

WITNESS: ROGER CRYAN, Ph.D.

WITNESS: DENNIS WOLFF

WITNESS: KEN DIBBELL

WITNESS: WILLIAM BEEMAN

WITNESS: SCOTT HERRING

WITNESS: TIM HOOD

WITNESS: BRIAN GOULD

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P R O C E E D I N G S

ROGER CRYAN, Ph.D.

a witness herein, having been previously duly sworn, was examined and testified as follows:

JUDGE PALMER: Mr. Cryan, are you ready to get back on the stand, Doctor? Sir, you are still under oath. Mr. Vetne, you were questioning.

CROSS-EXAMINATION

BY MR. VETNE:

Q. good morning.
A. Good morning.
Q. I think we talked a little bit about premiums yesterday and how they contribute to the rationale and the components of the National Milk proposals. One of the points you make is that premiums for Class I have increased substantially, and that is one of the reasons given for part of the proposal or for justification for the proposal; correct?
A. Yes.
Q. The premiums that you are referring

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to are they the announced property Class I prices that are published by the USDA?

A. Yes.

Q. With respect to those announced cooperative Class I prices, are you aware that the cooperatives that announce such prices may have programs within that premium structure whereby credits are given to buying handlers for certain things such as competition, such as new formula receipts and other things?

A. I don't have specific information about that.

Q. My question wasn't whether you had specific information. My question was whether you were aware that kind of thing exists?

A. I have heard of that.

Q. Do you believe that that exist within the Class 1 pay structure to which you refer?

A. I have heard of that. I don't know.

Q. You don't have a belief one way or the other?

A. I don't ask for that particular information. So I don't know.

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Q. Are you aware that the announced Class I prices to which you referred contain elements of specific services for the customers to whom those Class I prices are charged?

A. I'm sorry. Could you restate your question.

Q. Are you aware that the announced Class I prices, cooperative Class I prices contain specific elements of services to the buyers that receive them?

A. I testified to that yesterday. The component over-order premiums includes cost for services.

Q. And that would include balancing services, transportation services, that kind of thing?

A. That would include some specific services that are costs that are very specific to supplying that particular order of milk.

Q. Your testimony, as I recall, tell me if I'm wrong, was to the effect that the Class I premiums are necessary to attract or add to supply of milk to fewer milk plants and, therefore, a regular increase is justified. Is

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that a correct paraphrase?
A. Yes.
Q. Did you with respect to any cooperative over-order pricing structure examine, question or inquire of the cooperative how the premium revenues are being spent and for what services?
A. No, I did not.
Q. Do you have any independent information or study upon which you rely that would give information on how those revenues are being applied to services?
A. I do not.
Q. Did you make an inquiry or refer to any study that would disclose how much of those increase in Class I prices are due to market power as opposed to services?
A. Could you define that.
Q. By market power I mean other than services charge of --
A. I'm sorry. I couldn't hear that.
Q. I'm talking about charges other than for services that are charged simply because of one -- and the buyer because of that is willing

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to pay, market power.

A. I don't think that's clearly enough defined to base an answer on.

Q. Let me ask you if you exclude services cost incurred that premiums are made, is there a definition of market power that you would employ as an economist which you could explain to me how you might look at a premium structure to identify service related or market power related charges?

A. Well, as I stated yesterday, there are certain costs that a Class I supplier bears just to bring a particular load of milk to a bottling plant, and there are other costs that are associated with involvement in the federal pool, including number of costs that I discussed as needing covered in the Class I price. So everything is associated with costs which it's just a matter of what is appropriately associated with the overall premium and what's appropriately associated with the Class I structure.

Q. Let me ask it in this way then. Have you examined any data made in the inquiry

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concerning what portion of announced Class I cooperative premiums as related to the costs of which you speak?

A. Could you restate the question.

Q. Have you made any inquiry or done any study by which you can identify what portion of announced cooperative Class I premiums are related to the costs of which you speak?

A. Well, they are all related to costs. They are all related to costs, as I said.

Q. They are related to costs because they are charged? Everything that is charged is related to costs?

A. It's a competitive market.

Q. Are all markets equally competitive?

A. What do you mean by that?

Q. Do all markets have the same number of sellers and the same volume of alternative seller of milk?

A. Obviously not. Every market does not have the exact same number of buyers and sellers.

Q. So when you say it's a competitive

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market, would you agree that however you might define competitive market there are differences in competition from market to market?

A. I don't understand what you mean by that.

Q. That is why I asked you to use your own definition of competitive market out there. Whatever you have in mind would you agree that there is a difference from market to market? I'm not defining the term. I'm going into your head and asking you.

A. There are competitive markets. They are all competitive markets.

Q. They are equally competitive? However you're using the term.

A. That is an irrelevant question because nothing is exactly equal.

Q. Are there substantial differences as you're using the term in competition in markets for Class I?

A. I have not made a study of that, and I'm not going to answer that question.

Q. On the bottom of page 19 of your statement the last sentence you refer to the

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USDA model or the model and analysis of their proposal and opine or interpret that to include that blend prices will be increased for all markets for at least the first two years. In your use of the term all markets do you mean every market, or was that inaccurate?

A. Every federal market, each federal market.

Q. Can you maybe direct us to a page of the analysis in which the individual markets are broken down.

A. Individual markets are not broken down.

Q. So you're making an inference from --

A. Can I finish. According to the department's anaylsis, the Class I price in 2007 goes up by $0.71. The Class III price goes down by -- I'm sorry. The Class I price goes up by $0.70, and the Class III price goes down by $0.6. Just looking at those just for simplification, looking at those two, there is the market in the country with the lowest class utilization has 16 percent class utilization.

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That means that there is about five and a half times as much non-Class I milk as Class I milk. Since the Class I increases more than five times larger than the Class III decrease, there is a positive impact on the blend, and there is additional positive impacts. As you go forward it's more complicated calculations, which I don't have in front of me, but, as an example, it's clear from looking at the individual class prices that the blend even in the lowest class addition market is increased over the next two years even given the assumptions, even given some of the pessimistic assumptions of the USDA market?

Q. What table were you looking at class prices at 85?

A. 87. 85 works too.

Q. 87?

A. It's the same in 85. Class I goes up by $0.66. Class III goes down by $0.7. It's still Class I price goes up by more than five and a half times the production in the Class III price. That doesn't take into account the increases in Class II skim or

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butterfat which also contribute to increase in the blend prices in all milk.

Q. So the projected increases or decreases in the Class I price and projected increases or decreases in the other class prices, plus a look at estimated utilization is sort of a shorthand way to look at future impact on individual markets?

A. Yes.

Q. On the next page, page 20, first paragraph last sentence you express a belief that the impact will be positive in all Federal markets indefinitely?

A. Yes.

Q. And your meaning by you mean every?

A. Each.

Q. Each and every. Okay. Is that belief based on any model or any analysis that you have conducted?

A. It is based on my assessment of trends in U.S. interaction with the world market, increasing in exports, increasing connections to international dairy product markets which moving forward will make our dairy product markets less responsive to individual changes in the domestic market and more lend to lower prices. That is not an uncommon belief.

Q. Has that belief by you or anyone that you know been similarly modeled for components?

A. Well, as a matter of fact, I discussed this with Dr. McDowell, the USDA economist last week, and I expressed my concerns that the econometric model may be reflecting a past history that is more closed, a more isolated U.S. market than maybe reflected or that may have been moving forward, and he agrees that that is a potential issue, and he said that the department, his office, is, in fact, developing a world model of sort in order to take that into account in any future analysis.

Q. Is the bottom line component in your conclusion on page 20, is that modeled or analyzed in any publication or source, if not published for that matter, that your proposals will be positive on that blend in every market

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indefinitely?

A. It has not been modeled in the detail that Dr. McDowell has modeled. It is Dr. McDowell's model and results under his current model, and I certainly look forward to his future analysis based on the revised consideration of the world.

Q. Do you know of any other academic or government analyst that has concluded those proponents in any model?

A. In the three weeks since the announcement?

Q. You know you talked about future world trends, not timing of this announcement. I'm looking for something else that addresses those trends that you talk about.

A. I don't have a citation at hand, no.

Q. Without a citation are you aware of any such thing?

A. I'm aware. I don't have any specific -- I don't have anything that I can cite for you.

Q. Is it not true that models typically take some look at economic behavior

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of the past and the model put numbers on that such as elasticity and apply the past observed behaviors to the future?

A. That's what I testified to, yes.

Q. That's the nature of a model?

A. That is the nature of most quantitative models. In particular, it's the nature of the type of econometric model is the basis for USDA analysis.

Q. And the integration of the U.S. dairy market, world market to which you testified are circumstances that necessarily have not yet been observed?

A. They haven't been observed, but they've been observed over time. You know, as we approach the present, they are not part of the full decade of data that goes into the model. If that trend continues, it will create a different situation in the next nine years.

Q. By trends continuing you mean that economic behavior or responses to economic signals will be different, because the signals will be different in the world market as opposed to a very domestic market?

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A. Could you ask that question again.

Q. You indicate that there has been integration of the US dairy market with the world market.

A. Tendency towards integration.

Q. And you believe that that will continue in the future; right?

A. Whether we like it or not.

Q. And if indeed that does continue in the future, there will be new input components of economic signals to which it will be new economic responses?

A. You can put it that way, yes.

Q. Let's go back to the McDowell model for a minute or the USDA model used by McDowell.

Let me go someplace else first. Are changes in milk production technology, farming technology, farming practices, changed the way in which producers respond to economic signals?

A. What do you mean by that?

Q. Producers have an incentive to make a profit by producing more milk. Does current technology or management practices help them do that better today than it did twenty years ago?

A. That is a very complicated question, more complicated than I care to answer.

Q. I was looking for a very general.

A. It's a very complicated question.

Q. Well, we at least agree that farms are larger now than they were on average twenty years ago; correct?

A. That is trend. My average, yes.

Q. And that's a trend that continues?

A. Yes.

Q. Larger farms and fewer farms?

A. Yes.

Q. Do you have an opinion on whether larger farms are much larger farms than average are able to respond more efficiently to economic signals than smaller farms?

A. That is also a complicated question.

Q. One of the complications, for example, is source of feed and alternative supplies of feed and nutrition components in feed. All of those things are part of the complication?

A. Some of the complication is included

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in the fact that small and large farms respond to increases and decreases in price. The complications are facts that large farms often have large investments that are hard to adapt. There are many factors that make it very complicated to say whether or not small farms or large farms respond more quickly or less quickly or more effectively or less effectively to changes in economic factors. You can write a book about that.

Q. You indicated that small farms and large farms respond differently to prices. In what manner do they respond differently?

A. I just said that is very complicated.

Q. I understand that, but you at least indicated that they did. How would we observe? What observations would we make if we were looking at production response, for example, on a large farm compared to a small farm?

A. I don't have an answer for that.

Q. How far back in observations do models go in order to make confident projections that what was observed in the past

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which probably --

JUDGE PALMER: I think we are getting too theoretical here at this point in time. I would like to stay with the issues before us which really are about a specific proposal and not about how economists in general put together models. I presume he's put his model together. If there is a problem with his model, I would ask him about his model.

MR. VETNE: He has no model. He's making conclusions from the USDA model.

Q. You indicated that the USDA model is based on observations going back ten years?

A. That's my recollection.

Q. And that would be observations about how consumers respond to changes in milk prices?

JUDGE PALMER: Since he is deriving it from the USDA model, if there is a problem with the USDA model, I think it will be up to you to bring forward some evidence about that rather than asking him who's dependence upon is being relied.

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MR. VETNE: You mean interpretations of the model. I'm probing his interpretations, what he believes that model contains.

JUDGE PALMER: Well, he relied on the model and took off from where the model is. I really think if there is a problem with the model, it would be up to you to show what the problems are.

I'm not trying to stop you from questioning. I'm just trying to move the proceeding on a little bit.

Q. Link online from the notice of hearing, the USDA web page, is both the analysis and the USDA Dairy Program National Economic Model documentation. Page 1 of the USDA National Economic Model documentation says that, "The model supply and demand equations are estimated using data from the years 1980 through 2004," which of course we all know is a period of 24 years.

Was there any other --

MR. BROSCH: If he is going to refer to the document and he is going to read

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to it, can you show the witness the document.

JUDGE PALMER: I think the doctor was looking for it. Were you able to find it?

THE WITNESS: I don't have it in front of me.

Q. I hand the witness the first page of that model documentation in which I put a little mark by the line I just read, and of course it's in the notes of hearing.

A. That is fine. Actually, that is more strongly to the point that I'm making about the model being based on past history that is not necessarily representative of the next ten years.

Q. On elasticity that is not necessarily represented?

A. Not elasticity.

Q. Isn't that what you said?

A. No. I said on past history.

Q. But it does, of course it does represent, among other things, supply elasticity and demand elasticity for a period of 24 years. Is that what you interpret this

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to say?

A. It says that the model is based on the way that the U.S. dairy industry interacts with consumers and with the rest of the world in the past, over the last 24 years rather than the next ten years. And in particular, especially in the 14 years before the last 10 years there was very little interaction with the world market with respect to basic dairy models, and it reemphasizes my point that the model is based on data from a period that is not representative of the future going forward.

Q. Have there been changes in that 24 year period in consumer fluid milk in demand elasticity of which you're aware?

A. I don't have specific information.

Q. Are you aware of any changes in either direction specific or not?

A. It is my understanding that we have some extrication of improvement demand for fluid products moving forward that would actually also, could also tend to change the results of this, including the growth in Class I utilization.

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Q. My question was with respect to elasticity.

A. Elasticity is just a way to describe demand.

Q. What about supply elasticity? Have there been changes in supply elasticity during the past 24 years?

A. I don't have specific information.

Q. Without specific information, do you have any information or belief as to trend so that if one examined the most recent five years in this 24 year spread, the first five years or any other period, that there would be differences?

A. I have only testified as to whether or not the model captures what I believe to be the international trade situation in the next ten years. I have not testified to any other -- I have made no other criticisms to any other part of the model. If you have questions about the model, I think you should ask Dr. McDowell.

Q. Are you aware that there are several sources by which economists have estimated

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fluid milk and demand elasticity?

A. Could you explain that question.

Q. That a number of economists in various published data have made conclusions about the elasticity demand for fluid milk. Are you aware that there are several?

MR. BROSCH: Excuse me. Your Honor, he's asking about aware of several without specifying who these several people are. If he would say are you aware that Dr. A or Dr. B has done this, I think it would be helpful, but just to say several without any specifications isn't very helpful to the witness. I think he is going to have a hard time answering those questions.

JUDGE PALMER: I would like to see the questions be a little more pointed.

Q. Are you aware that there are demand elasticity studies other than that? He's not alone in the world; right?

A. That is right. He is not alone in the world.

Q. There are others. That was my simple question. My simple question is, is

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there others that have applied demand elasticity?

A. Yes, there are.

Q. That was as simple as the question was originally.

Have you examined with respect to any of those others how McDowell elasticity compares conservatively or not with other demand elasticity?

A. I have not.

Q. The same question with respect to supply elasticities. Do you know whether McDowell's is conservative or not?

A. I do not.

Q. Do you know what he involves in the ballpark of any others?

A. I do not.

Q. And yet, you conclude that his model is pessimistic. Do you know how pessimistic it was with respect to anybody else's as far as supply and demand?

A. It's pessimistic with respect to the impact, the potential negative impact that our proposals would have on Class IV prices

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specifically because it assumes a greater response in those basic commodity markets to those changes than I believe is to be expected, given increased interaction with the international market. It is only in that way that I'm characterizing it as pessimistic.

Q. And that response is one of a combination, among others, of demand elasticities for milk in the Class II products and supply elasticity encouraging producers to produce more milk?

A. Well, it's all about how you model the structure of the international trade, how you model international trade is part of the overall --

Q. What component of past observable behavior would you plug into a model that McDowell's does not use?

A. As I testified, I am not criticizing the model at all in terms of its interpretation of the past. What I am saying is that I believe that there are differences moving forward based on less statistically testable changes in recent years that will change the structure.

Q. Less statistically testable --

A. In the context of this model.

Q. In other words, things haven't happened yet, so you don't know how the behavior --

A. You have an econometric model based on 24 years worth of data and there is a trend change in the last several years that is not easily captured in the context of this type of model.

Q. What identifiable trend changes would you plug into a model to be able to project those things in the future?

A. Your Honor, I'm explaining that that is not relevant, because I can't just plug changes and not tell him.

JUDGE PALMER: That is your answer. Just say you can't do it for the issue that you are trying to address.

MR. VETNE: That concludes my cross.

But Your Honor made a good point.

JUDGE PALMER: I thought I

did.

MR. VETNE: There were questions I would have hoped to ask Mr. McDowell. I'm aware that he is not here. Maybe something was said during the early part of the first 10, 15 minutes when I wasn't here. But I did invite him in the notice of hearing, per the information in contact. I did that by e-mail in order formulation for Mr. McDowell asked if he was going to be here and it would be helpful for him to be here. It was early last week. I received no acknowledgement of those inquires and response, but I would make one now again. Can he be made available?

JUDGE PALMER: Well, this witness wouldn't be the one to respond. That would be up to the government table, and they hear you, and I guess after they've looked into that, they will let you know. I wouldn't ask them to say it right now. Take a little time --

MR. VETNE: If you can let me or let the record know if he can be made available for this hearing, I would appreciate it.

MR. TOSI: My name is Gino Tosi, T-O-S-I, with USDA.

We didn't feel the need to have any witness come to present the results of the study. The results of the -- it's a preliminary economic impact that basically says based on how we understood National Milk's proposal, this is what we think the outcome will be. The model itself is available on our internet website, and we were of the opinion that putting the witness on to explain what the study is was pretty much the same as putting a witness on to say what a decision says. And we think that economic analysis says what it says, and people are free to interpret it in any way they want. The model is available up on our internet site. People can use it and draw any conclusions that they want.

JUDGE PALMER: Apparently he is not going to be here. So that is the response.

MR. YALE: Benjamin F. Yale on

behalf of Select Milk, Continental Dairy Products and Dairy Producers New Mexico.

That response from the government is very troubling. This is a cornerstone piece of the decision making process, and we have as a right under the rules to cross-examination any such evidence as presented. If it's there, it's going to be used. You saw a lot of questions that could have probably been taken care of if Dr. McDowell was here, but that is part of the decision making process, and we have the right to challenge any of that evidence.

JUDGE PALMER: Well, he's --

MR. YALE: What brings up my point is that if it's not going to be there, then we move to strike it from the hearing notice and from the proceedings unless, in fact, we can cross-examine the witness.

JUDGE PALMER: I believe what Mr. Tosi said, and I'm trying to not get my thoughts into it, but just his, but I think what he said was -- Mr. Stevens, do you wish to address that?

MR. STEVENS: I think that Mr. Tosi expressed the Department's view on this matter. Let's get one thing straight. This is not Dr. McDowell's study. This is a study that is done under the illustrious Department of Agriculture. It's a government study. It is a draft document. It is prepared and given at this hearing just like the statistics that come in a hearing for people to use as they need to do it. Let's be frank about it. The government witness that would testify to this is going to stand by his study. That is the study of the Department of Agriculture. It is a study which is used by the people at this hearing for their purposes. And if you have other studies, if you have other experts, then educate the Secretary as to somehow you have a better view of it. That's what the Secretary wants to know. This is a draft study done. Inform us as to how this -- and that will be taken into account. So it is in the nature as Mr. Tosi described it. It's up on the website. It's available for everyone to use just like the statistics.

MR. YALE: I appreciate that. At least we are now starting to see these studies before the decision comes out, and I appreciate that. The problem is that there are some issues in that study that go to its value, and we don't have the model. I don't have the ability to change one of those numbers and see what that impact is, how it changes the rest of the tables. And to just lay it out there and be part of the record it's a frightening proposition, because if we can do it on this part, then they can do a study, for example, on make allowance as a government thing, and that's it. We don't get to cross-examine that witness. Where does it end?

JUDGE PALMER: I guess they are thinking of this a lot like the statistics you get about milk prices here and there and everywhere else, make a pile and then you can use it. But if there is a mistake, you can bring forward evidence to show that there was a mistake. They're happy to hear that and they'll adjust, but what they are telling you is based upon what he had before him, this is his study and his model and it's there. If there's a problem with it, bring out facts to show the problem, but you have to do that. If he were on the stand, for him to say okay. I'm wrong. You would have to say here's so and so, and what they're saying if you put in evidence showing here's so and so, and they come up with their proposed decision when taking it into consideration. I'm going to leave it stand there.

MR. YALE: The other thing you mentioned is statistics. Historically we've always been able to question those statistics and have, in fact, found errors and had corrections and other data added to it, and that's the same situation here. At least let our objection be noted.

JUDGE PALMER: Your objection is noted.

MR. VETNE: Again, I missed the first 10 or 15 minutes of this hearing. Is this the detailed analysis and the model that was used which are linked through the internet, are they exhibits? Have they been received?

JUDGE PALMER: We received his statement which is Exhibit 5 and it had certain tables attached to it.

MR. VETNE: I'm talking about the USDA model.

JUDGE PALMER: I don't know. Was the model put in? I don't remember any government statistics.

MR. STEVENS: The model was not put in as an exhibit. It is part of the administrative record. The hearing notice is up on the website. All of this will be available in the hearing clerk's office as part of this record.

As I said earlier, if the parties want to present studies, if they want to point out errors in that, that's their right certainly to educate the Secretary, but to have a witness up here, you know, is one way to do it, I suppose, but certainly it can be done by reviewing the record, determining what other points you want the Secretary to know and let the Secretary know that, and that will all be part of the record.

JUDGE PALMER: Well, it's got an exhibit that came in during yesterday.

MR. VETNE: As I understand it, it is to be treated as officially noticed even though a paper copy is not part of the record; is that correct?

JUDGE PALMER: That is about it.

MR. VETNE: As I also understand, the USDA's position on it is the model, the analysis and its documentation are there, and as long as there is no genuine issue of material fact and dispute with respect to that, why call a witness when there is no factual dispute.

JUDGE PALMER: It sounds like it, yes. Any other questions for this witness? Yes, sir.

MR. HARNER: My name is Tim Harner. I represent Upstate Niagara Cooperative and the O-AT-KA Milk Products, and today I'm pinch hitting for Marvin Beshore who has an appearance in court in New Jersey, Upstate Farms and are members of ADC that

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Marvin Beshore represents and we are business partners of O-AT-KA DFA.

CROSS-EXAMINATION

BY MR. HARNER:

Q. Dr. Cryan, I have just a few questions related to the relevance or lack of relevance of aggregate US milk production figures to the availability of fresh fluid milk to consumers. Do you expect that the milk will be fresher for consumers if it was produced more close to the consumers?

A. Yes, I believe.

Q. Why?

A. Because it's fresher. It's newer. It spends less time on the road.

Q. Do you recall in your prepared testimony, pages 4 to 5, you discuss disorderly marketing conditions that exist through the inadequacy of Class I and Class II pricing?

A. Yes.

Q. And will those kind of deserving marketing conditions continue even if there were an increase in production someplace that

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does not service a particular marketplace?

A. Certainly.

Q. Why?

A. Because fluid markets that are local or regional and aggregate production figures in the whole country don't necessarily represent availability for supply for any particular market.

MR. HARNER: No further questions.

JUDGE PALMER: Yes, sir. Again, for the record, state your name.

MR. ROSENBAUM: I'm going to have a couple of exhibits. Steve Rosenbaum, International Dairy Foods Association.

CROSS-EXAMINATION

BY MR. ROSENBAUM:

Q. Dr. Cryan, on page 9 of your statement which has been marked as Exhibit 5 you talk about an increase in non-feed costs between 1998 and 2005; correct?

A. Yes.

Q. I have given you two single sheets;

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one of which is called US milk production costs and returns per hundredweight sold 2000 to 2005. Do you see that one?

A. Yes.

JUDGE PALMER: We'll mark that Exhibit 11.

(Exhibit No. 11 was marked for identification.)

Q. Is this the document that you used to obtain the 2005 costs figures?

A. I don't know if it's the specific document, but they are the same source. They appear to be the same source.

Q. Could you please identify for us by line item which costs you included in what you termed non-feed cost in the production cost?

A. You can see by comparison with Table 1 in my testimony, in my prepared statement, the total costs listed corresponds to the total in that table, and the feed costs correspond to the total feed costs in the ERS table. That is to say the total feed costs in the ERS table corresponds to the feed cost in my table and the total costs listed corresponds to the total

R. Cryan - Cross

costs in my table, and the non-feed costs is total cost minus feed costs.

Q. So taking Exhibit 11, looking at the 2005 column under the heading operating costs, there is a subcategory called feed that runs up to a line called total feed costs; correct?

A. I'm sorry. Can you ask the question again.

Q. Under the heading operating costs on Exhibit 11 there is a subcategory called feed, and it runs up through a row that's called total feed costs; correct?

A. Yes.

Q. So you excluded that in looking at non-feed costs; correct?

A. That is right.

Q. And then there are a series of additional items still under the heading operating costs that include -- well, the first of which is veterinary and medicine and the last of which is interest on operating capital; correct?

A. That is what it says, yes.

Q. And you included those in your

R. Cryan - Cross

determination of what you call non-feed costs; correct?

A. I included everything included in the total costs on this table except for the feed costs.

Q. So the answer is yes to my question?

A. Yes.

Q. And I think we are getting the same point just from different directions. But I just want to make sure I understand this correctly. The next set of costs listed are allocated overhead. Do you see that?

A. I do.

Q. And obviously, from your previous answer you included all of that in your calculation of non-feed costs; correct?

A. Yes.

Q. You'll note that this Exhibit 11 is based upon -- well, let me start that again. Exhibit 11 only covered the year 2000 to 2005; correct?

A. Yes.

Q. You'll note that this data says based upon the assumption of a farm or average

R. Cryan - Cross

farm that is only grown from 93 cows in 2000 to 96 cows in 2005. Do you see that?

A. I'm sorry. Can you say that again.

Q. I'm looking under the supporting information at the bottom, towards the bottom of Exhibit 11. Do you see where these costs figures are based upon herd that is 93 cows per farm in 2000, and 96 in 2005? Do you see that?

A. Yes.

Q. Have you done any analysis to whether that accurately reflects the actual increase in herd size, average herd size?

A. I don't have those numbers in front of me.

MR. ROSENBAUM: If I could then ask to be marked as Exhibit 12 the other document --

JUDGE PALMER: So marked.

MR. ROSENBAUM: -- which is called U.S. milk production cash costs and returns per hundredweight for 1993 to 1999.

(Exhibit No. 12 was marked for identification.)

Q. And I can represent this is USDA

R. Cryan - Cross

data. I just want to confirm whether this is the source of your information with respect to your determination as to what the non-feed costs were in 1998 which is the starting point of your analysis?

A. Is that a question?

Q. I was asking whether this was the data source for the -- let me back up. On page 9 you make a comparison between what non-feed costs were in 1998 versus 2005; correct?

A. Yes.

Q. So I'm simply asking whether Exhibit 12 is the data that you were using for your 1998 information?

A. It appears to be the same data.

Q. Did you perform any analysis of whether the methodology utilized by USDA changed between the period of 1993 through 1999 which is the information set forth in Exhibit 12 and the 2000 through 2005 data set that is Exhibit 11?

A. They did make some changes in the arrangement.

Q. One difference that sort of leaps

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out perhaps is hired labor which in Exhibit 12 is shown as actually declining from $0.69 in 1993 per hundredweight to $0.55 in 1999. Do you see that?

A. I do.

Q. And then leaping by more than double between 1999 and 2000, going from $0.55 as shown in Exhibit 12 to $1.14 in Exhibit 11. Do you see that?

A. Can you say that again.

Q. Do you see how hired labor is shown as declining between 1993 and 1999 on Exhibit 12?

A. Yes.

Q. Dropping from $0.69 per hundredweight down to $0.65 per hundredweight?

A. Yes.

Q. Do you see where in Exhibit 11 which picks up the year 2000 hired labor is shown as more than doubling to $1.14 per hundredweight?

A. Didn't you just ask me that?

Q. Yes, but --

A. I said yes.

Q. Did you perform any analysis as to

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how that could be?

A. I did not.

MR. ROSENBAUM: That's all I have.

JUDGE PALMER: Questions?

MR. STEVENS: Your Honor, are you admitting those two exhibits?

JUDGE PALMER: They weren't offered.

MR. ROSENBAUM: I am offering them.

MR. STEVENS: As to those two exhibits, could you state for the record the source of the two documents. It's not apparent from the document.

MR. ROSENBAUM: The source of those documents is the same as Footnote 11 of Dr. Cryan's testimony which is USDA.researchservicewww.ers.USDA.gov/data/costandreturns/testpick.htm.

JUDGE PALMER: They are both received.

(Exhibit Nos. 11 and 12 were received into evidence.)

R. Cryan - Cross

JUDGE PALMER: Yes.

MR. YALE: I want to follow up a question that Harner asked and that deals with expression issue.

CROSS-EXAMINATION

BY MR. HARNER:

Q. Are you familiar with the PMO requirements in terms of how long milk can remain at the farm before it's picked up?

A. I don't know specifically, no.

Q. Do you recall every other day pickup?

A. I'm aware of that.

Q. And that's common in a lot of areas? Are you aware of that?

A. I don't know.

Q. Is your statement that it's fresher because there is a shorter time between harvestry from the cow and the time it gets into the dairy case? Is that the basis of your --

A. I said it tends to be. I did not -- certainly it depends. Certainly one of the big

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differences of course is the cost of -- which is one of the factors, one of the reasons local supplies are local and closer supplies can be better and more effective and more efficient because they are lesser expensive to ship.

Q. But not necessarily to say their milk is fresher?

A. Not necessarily.

Q. Have you done any studies to determine long haul milk versus local milk?

A. No. Obviously, the big issue is how it starts up.

Q. Quality begins with the cow and the milk?

A. Right.

Q. If milk is harvested and fills a tanker every three hours and then that milk is delivered within 24 hours to as much as 1,000 miles later, that milk is every bit as fresh, if no fresher, than everyday pickup; is that correct?

A. That's correct. It could be.

Q. So without no specifics you can't generalize --

R. Cryan - Cross

A. I'm not making any -- all of the things being equal, milk has been on the road longer is not as it has been longer from powdering case. However, I'm certainly not making any disparities on long haul milk.

Q. It's not the function of how long it's been on the truck; the function is how long it's been since it's been harvested before it gets to the case. So part of that may be the link to the transportation?

A. Right.

Q. Part of it may be how long it's held at the farm?

A. I would assume, yes.

MR. YALE: I have no other questions.

JUDGE PALMER: Other questions? Yes, Mr. Tosi. If you wouldn't mind giving your full name for the reporter.

MR. TOSI: Gino Tosi, G-I-N-O, T-O-S-I.

JUDGE PALMER: And you are with the Department of Agriculture?

MR. TOSI: Yes.

R. Cryan - Cross

CROSS-EXAMINATION

BY MR. TOSI:

Q. Good morning, Roger.
A. Good morning.
Q. I want you to suppose for a moment that we weren't going to make a $0.77, if your proposal didn't ask to or proceed to making an adjustment to Class I milk, without making that $0.77 adjustment, would your revised formulas result from the same Class I price mover as the current formulas do?
A. The formula in my statement if you remove the $0.77 increase, aside from rounding differences, would be the same as the formulas that would result for Class I would be the same as the formulas that would result from the make allowances that were published on November 22nd, yes.
Q. All other things being the same, either using current make allowances or perhaps a new future make allowance, what you are saying is that how the Class I price movers have determined now would be the same under

R. Cryan - Cross

your revised formulas absent $0.77.

A. That question is a little bit different. If there were future changes in the make allowance, especially depending on when those future changes in the make allowance were, we believe it would be appropriate to consider those as they apply to Class I only in the context of the consideration of all of the costs that are built into the Class I and II prices. So laying out these formulas would allow a stepwise revision so that the Class III and IV formulas could be looked at on their revised and then subsequent proceeding could update Class I making use of those changes and whatever information is necessary to fully update Class I and Class II prices. That's our hope.

Q. May I restate what I think you said and you tell me if I have said it correctly. I think what you're saying is that with your new formulas, together with the $0.77 adjustment, that if in the future we go to examine some feature of how we do our classifying price, whether it be make allowances, for example, and

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we are looking at cost that manufacturers incur in producing, the manufactured products that we use to set minimum prices, that in setting the formula the way that you propose it would necessarily also require us to look at what the cost that producers incur in supplying the Class I market. That it will all happen at the same time?

A. Well, it can be done in different ways, but it is our -- it could be done as I said, and I guess in the sequence of hearings or it could be one hearing considered in all of the elements, including the Class I, II supply price. Our hope would be that Class I and II prices would only be revised in all elements of the formulas are considered, because it is specifically a tendency that rising manufacturing costs can tend to correlate with the rising Class I supply costs just because the costs are rising in the economy. They tend to rise together. So that's the same reason we were asking for this decision to be made on an expedited basis. If you only adjust the make allowances and apply to all four classes, you

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kind of overshoot the overall impact when you could have, you could and should have offsetting impacts from full consideration of Class I and II supply classes. Does that clarify it?

Q. To the extent that the Federal Order program no longer has no real competitive pay prices for the MW, for example, and that we are relying on formula product pricing, are you saying that there has to be a proper relationship between all of the classes, because if there isn't, we are begging for, for example, disorderly marketing conditions?

A. Well, the short answer is yes, and the longer answer is that my statement in my proposal makes it pretty clear that we recognize the logic has gone into the current present system. Most of what we are suggesting -- in fact, everything that we are proposing follows from logic that's already been applied to the current pricing. It just tends to -- recognizing, yes, in the long run and as you move along that the Class I price formulas aren't necessarily going to be related

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to the manufacturing Class I prices, manufacturing Class I, but they should be done -- somehow they should be done in total. Class I changes should all be applied at one -- Class I should all be applied at once so you don't have this sort of uneven taking stuff away, just store away, but in the meantime it's lost. The revenue in the meantime is lost.

Q. Using that thinking, are what you are saying, for example, if the relationship or that we are not properly reflecting the costs and our minimum pricing that additional costs that producers incur in supplying the Class I market, but we are more adequately reflecting in the formulas for the Class III and IV prices that producers that are supplying the Class I market aren't being -- that the additional costs that their supply is not being adequately regarded in the minimum price? Is that what you're saying?

A. Right.

Q. If the department included that your proposal has merit but chose to because this increases the Class I by $0.77 in all markets,

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if they chose to reflect that in the level of the Class I differential, would that somehow disrupt the objectives of what you are seeking in your proposal?

A. Well, as my testimony indicates, that the $0.70 could be as effectively applied to Class I differential or to the Class I mover. So it would achieve the same result, although we do believe that establishing the distinct set of price formulas based directly off product prices for Class I and Class II has its own merits.

Q. Now, to the extent that some of the questions that you've been asked before dealt with over-order premiums and prices above the minimums, how do you answer over-order premiums representative can adjust or fine tune the minimum prices that we have that perhaps aren't or may be are adequate to bring forth milk allocations where Class I and II are made?

A. Well, I would say the over-order premiums you can't fine tune them the same way as premiums generally you can fine tune questioning them in the milk market. But just

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like with any minimum pricing -- if the minimum price is too far below the market level that we're seeking, it doesn't have the effect it's intended to have, and certainly there are, as I testified, there are elements of over-order premiums that go to any specific costs for delivering milk to a specific plant, and there are other elements that at some point begin to be necessary to draw the milk into the pool to meet pool standards to draw milk into the pool to serve that plant that should be rather in the Class I price should be to compensate those same costs to all of the suppliers that are bringing milk into the pool and available to the Class I market.

Q. So in the context of our minimum class prices and given the extent that they all have a cost component, cash component, is it your testimony that in the context of the minimum prices that the industry is going to rely upon and the rest of the dairy industry will turn upon that those costs need to be accurate and determined at the same time?

A. Yes.

R. Cryan - Cross

Q. As closely as possible?

A. Correct. That there is cost associated with meeting the minimum standard of the pool. Certainly it could be associated -- it could be at least associated with the Class I price, but those costs are not necessarily associated with specific costs from a specific load to a specific plant. It should be in the Class I prices.

Q. I would like to go back and revisit the three major components, if you will, that comprised the proposed $0.77 adjustment rate. Your testimony, as I recall, is that with respect to the Grade A, either conversion from Grade B to A or the maintenance of Grade A production, your source is primarily the Economic Research Service?

A. That's the source for the milk class production, yes.

Q. When you say that you conservatively estimated at $0.15 per hundredweight increase over the rationale for $1.60 level differential from $2.00 --

A. Yes. What was the source?

R. Cryan - Cross

Q. Yes. Is the ERS study that is the source, but at the same time you're saying --

A. Why am I saying it's a conservative estimate?

Q. Yes.

A. I'm saying it's a conservative estimate because I'm applying the percentage increase. Even though arguably it may be -- there is a fuel increase in cost that should be compensated in the market. Now I'm simply talking about percentage increase which may or may not be fully represented.

Q. What information would you need to determine -- would you need to rely on another source over the ERS study, the ERS operating costs for production, non-feed cost?

A. Well, I couldn't find any source of data on cost of maintaining -- establishing or maintaining Grade A status, and I found researchers who had gone to great lengths, it was not feasible to break those up. So relying on the number established for the record in 1998 I used the non-feed costs of production as it was an appropriate cost for something that

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would move in proportion with those costs if the remaining costs are similar and applying the same 38 percent increase in that cost production in 1999 to 2005 to the original $0.40 that was determined by the department to be representative of those costs of maintaining Grade A standards.

Q. And in doing it that way, you determined that or you assert that this is a conservative estimate?

A. I believe so.

Q. Moving on to the next part, balancing and transportation hauling. Those in total in your testimony says the total amount is $0.23; is that correct, $0.10 per balancing?

A. Yes.

Q. And $0.13 for hauling and transportation?

A. Right.

Q. For the $0.13 balancing you are relying on past decisions of the department?

A. Yes.

Q. And with respect to transportation, you are relying on two market administrative

R. Cryan - Cross

staffers, one from the Upper Midwest and one from the Pacific Northwest?

A. As well as data presented at the recent transportation tax credit hearing on cost and volume, but largely on the Seattle and Minneapolis market administrator establishment, yes.

Q. Which transportation credit hearing are you referring to?

A. The one -- well, actually, if I could cite it in here. Let me withdraw that. I'll go by whatever is in my statement. If I haven't referenced the transportation credit -- I don't see that I have referenced that. Here I have Federal Register Reference to the decision 71 FR 54118 and the following. It's referenced in the footnote on page 10. It was concluded at that hearing that there has been substantial increases in hauling costs.

Q. Is that the hearing that had to do with the inter market transportation credit in the Southeast and evolution?

A. I believe this was the decision on the inter -- did you say inter or intra?

R. Cryan - Cross

Q. Inter market. Where the Southeast has a transportation credit?

A. The department has already been decided.

Q. Is there a reason why you were looking at the staff papers of -- is there something that is important about what it cost in the Upper Midwest and the Pacific Northwest being reflective of something that we can apply to the rest of the nation?

A. Well, the 1998 decision relied on discussion about conditions in the Upper Midwest as the representative surplus market, as the market where the minimum Class I price should be declined because of the surplus nature. Surplus in terms of the decisions used to award surpluses. The markets are substantial very large manufacturing share of the pool. The Pacific Northwest numbers are more chronologically comprehensive. They go back to the appropriate period. They are of some interest as well as some part of the milk in those markets associated with some manufacturing areas, but that is less

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significant in that case. It's a matter of these numbers being representative of increasing hauling costs. They seem to be consistent.

Q. Consistent with what?

A. Consistent with increases in hauling costs with the Minnesota Upper Midwest market and the Pacific Northwest market.

Q. These market administrative staff papers are they kind of regarded for their accuracy for completeness?

A. To my view they are. I have not talked to a lot of people about them. I typically give credit to the complications of dairy programs.

Q. Are market administrative staff papers and such are they things that you routinely receive from market administrators?

A. I do and at one time I produced some.

Q. Moving on to the third component or competitive factor. That total is the $0.39. That is your testimony, $0.39, approximately?

A. Yes.

R. Cryan - Cross

Q. The way I see you're saying that you came up with that number by this was a survey done by NASS of average premiums?

A. Well, it's two sources; the same two sources that were relied upon in the proposal in 1998; one is to compare all milk prices to manufacturing milk prices, and the other is to compare, is to look at the over-order premiums in the three metropolitan markets in the Upper Midwest, Chicago, Milwaukee and Minneapolis. To the extent possible in this case I looked specifically at the same numbers that were applied in the 1998 decision, in the 1998 proposed rule which became the basis for the final rule.

MR. TOSI: That's all I have. I want to thank you for your time and your patience and work appearing here today.

THE WITNESS: Thank you.

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

MR. VETNE: Your Honor, I have three areas that I would like to address.

R. Cryan - Cross

CROSS-EXAMINATION

BY MR. VETNE:

Q. On page 16 of your statement concerning Class II pricing. You refer to a panel survey of dairy processors. You refer to a survey of dairy processors and stated that you conducted a survey. What kind of survey was this?

A. A panel survey is where you bring together a number of people who are experts who are involved in a particular field with specific knowledge, and rather than revealing individual proprietary information, they are encouraged to arrive at a census on whether an appropriate or representative cost or some other numbers are, whether it's -- you can examine anything at all, whether people have specific information, and I had a group of dairy processors conference call where we went over costs of condensing rehydration and arrived at these numbers. I believe they are representative of these costs.

Q. You selected the panel telephone conference participants?

R. Cryan - Cross

A. Yes.

Q. And this occurred when?

A. This occurred within the last two weeks.

Q. And this was done in preparation for this hearing?

A. It was.

Q. Were the panel participants processors who are also cooperative members of National Milk?

A. I believe they are, yes.

Q. Are these also participated supportive of the National Milk proposal in this hearing?

A. Yes.

Q. You made no effort then to gather a mutual memorandum survey group?

A. Well, many of the participants were asked about condensing and rehydration costs without understanding which direction -- to which direction the -- without understanding whether increasing or decreasing their estimate would impact the result in the price up or down. It was a relatively abstract discussion

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at that point. It was only after we established the condense and rehydration costs that did I discuss what they meant for purposes of this proposal, and then asked whether or not the current balance between the powder price and Class II skim price was a good balance or was an appropriate balance and whether it served well on one hand to get the most value, appropriate value, for farmers and on the other hand avoiding the loss of Class II condensed skim sell to powder.

Q. Could you identify the organizations that participated in the survey?

A. No. I don't wish to do that at this point. I haven't discussed that with them.

Q. Could you identify the number of the different organizations that participated in this survey?

A. I believe it was six or seven.

Q. And among that six or seven participants how many people were involved in the telephone conference call?

A. I believe it was seven or eight.

Q. So more than one participant from

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some organization?

A. Well, in the case where there was more than one, it was someone who I was working with who brought in someone more appropriately described as an expert on this processing costs in the discussion, in this particular discussion.

Q. With respect to the other organizations, did you undertake any effort to make sure that the persons on the other end of the phone line were those within that organization that were experts in processing costs?

A. Well, in the same way when I was at the University of Florida, I worked for some professors who did panel surveys with dairy farms on a regular basis. In that sense, they only determined that the dairy farmers were experts in dairy farming by the fact that they were dairy farmers, and the same way that I determined that these people were experts on costs because these people were cost accountants and the manufacturing managers who have to be aware of these costs.

R. Cryan - Cross

Q. Were the people on the other end of the phone in all cases the cost accountants for those organizations?

A. Is that a question?

Q. Yes. It started with were and ended with a little. Were the people on the other end of the phone in all cases cost accountants for those organizations?

A. They were cost accountants and plant managers and folks generally responsible for manufacturing.

Q. So there were a variety of different representations for different organizations?

A. They did not all have the same title, but they were all involved in plant operations and decisions about costs and operations.

Q. And some were cost accountants and some were not?

A. Yes.

Q. And this was all an oral discussion. Nothing was required of you or produced to you in writing?

A. No. That is not uncommon for panel

R. Cryan - Cross

surveys.

Q. And that is, in fact, what occurred in your case?

A. I beg your pardon?

Q. That is, in fact, what occurred?

A. That's correct.

Q. Did you provide any instructions or parameters about what should be included in the responses by the managers and accountants and others?

A. I relied on their expertise.

Q. Will you attribute to them lack of understanding about what we are doing at the beginning. Is that an assumption that you made, or is that an expression -- a representation they made to you?

A. That was from every reaction to my explanation.

Q. It was an inference you made from your discussion with them; correct?

A. It was my conclusion based on their reaction to my explanation of what we were doing after the fact.

Q. The other question has to do with

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your first page and National Milk's representation. Presenting this proposal on behalf of America's 64,000 dairy farmers represented by 33 coops and they are members of National Milk Producers Federation. In making this proposal were each of the member cooperatives contacted to determine their position?

A. Our position is the position of the organization.

Q. Organization as developed by the board of directors?

A. It's a position that is developed by the organization. I don't care to go into the details of how we arrived at our position.

Q. I'm just asking you whether they came from the board of directors or elsewhere?

A. I'm not going to answer that question.

Q. Is it not true that the members of your board of directors whether they approve this or not have members that are based on volume of milk represented in each member's organization?

R. Cryan - Cross

A. That's one factor.

Q. And the minimum volume of milk per member seat is 1.5 billion pounds per year; is that correct?

A. I don't have that number.

Q. Does that number seem inaccurate to you?

A. Since I don't know that number, I don't intend to answer that question.

Q. Do you have a belief of whether it's too low or too high?

A. I'm not answering that question.

MR. VETNE: That's all. Thank you.

JUDGE PALMER: I'm going to ask if anybody has questions. I'm not going to let you ask questions, but I'm going to ask if you have a question. Do you have a question?

MR. ROSENBAUM: We're going to recess now for 15 minutes, and then you'll be the first to ask questions.

(Short recess taken.)

JUDGE PALMER: Back on the record.

R. Cryan - Cross

CROSS-EXAMINATION

BY MR. ROSENBAUM:

Q. Steve Rosenbaum from the International Dairy Foods Association.

Dr. Cryan, if you could look at page 12 of your statement which is Exhibit 5. You make a comparison between the premium and the Grade A milk received over Class III in 1995 and '96 versus in 2004 and 2005 in Minnesota and Wisconsin; correct?

A. Yes.

Q. And the figures for 1995 and 1996 simply come from 1998 post rule; correct?

A. Correct.

Q. Could you tell us exactly how it is you calculated those numbers with respect to 2004 and 2005, if you need the application, I probably have them, but tell me if you can, explain it without them.

A. Those are the fluid grade price in Minnesota and Wisconsin Class III prices.

Q. Do those figures come from the USDA Publication Milk Production Disposition and Income 2005 summary and 2004 summary?

R. Cryan - Cross

A. I got those from the post status function on the NASS website which is a data based function projected directed from the NASS database and NASS public database. I got that website cited in my footnote.

Q. Well, I think your footnote just says NASS data. It wasn't more specific than that.

A. The home page for NASS has the first step with drawing data, extracting data from the quick stat formula.

Q. Did you perform any calculation to convert any of the figures that NASS reported to 3.5 percent butterfat content?

A. I don't recall.

MR. ROSENBAUM: I would like to mark two exhibits. Let me mark as Exhibit 13 the document I was holding a minute ago, Milk Production, Disposition and Income 2005 Summary published in April of 2006, and then I will also mark Exhibit 14 Milk: Annual average prices received by States and United States, 2003-2004.

(Exhibit Nos. 13 and 14 were

R. Cryan - Cross

marked for identification.)

Q. And Dr. Cryan, if you look at those documents, it doesn't seem -- let me hand them out first.

If you look at Exhibit 13 on page 5 there is a table that reports average returns per hundredweight fluid grade versus manufacturing grades. Do you see that?

A. I'm sorry?

Q. This is the 2005 summary.

A. Yes.

Q. And on page 5 there is information provided for average returns per hundredweight?

A. Yes.

Q. By state. Do you see that with somewhat different descriptors the same information appears on Exhibit 14 which is a one page xerox of NASS information Agricultural prices 2004 summary?

A. Yes.

Q. If one were simply to compare the difference between the fluid grade price and the manufacturing grade price for Minnesota and Wisconsin for 2004 and 2005 -- actually, let me

R. Cryan - Cross

back up a second. I think I took you to the wrong page, Dr. Cryan. Page 5 is also 2004 data. What I meant to do was take you to 2005 data on page 7. I'm sorry. The 2005 data on page 9. So the 2005 data is on page 9, and the 2004 data is actually available either on Exhibit 14 and now I see it's also on page 9 of Exhibit 14. So maybe we don't need Exhibit 14 at all. But, in any event, I just can't simply quite duplicate your numbers. So that's why I was trying to see whether you made some adjustments of some kind.

JUDGE PALMER: What is it that we are trying to get the doctor to look at? I'm a little vague here. I understand the exhibits, but what is it you want him -- you have a problem with some numbers?

MR. ROSENBAUM: Well, Dr. Cryan has a statement on page 12 of his testimony. In 2004 and 2005 these average premiums, meaning the premiums in Minnesota and Wisconsin, was $1.33 in Minnesota and $1.33 in Wisconsin, and I'm simply trying to find out how one actually get to those numbers because

R. Cryan - Cross

they seem to be --

A. That's the difference between fluid grade milk price and the Class III milk price.

Q. So for 2005 would that mean that you would look at page 9 of Exhibit 13 and identify in Wisconsin a $1.10 difference?

A. No, because the manufacturing -- these prices include premiums in those numbers, especially in Wisconsin.

JUDGE PALMER: Which include premiums, Exhibits 13 and 14?

THE WITNESS: Exhibits 13 and 14.

JUDGE PALMER: Which ones?

THE WITNESS: Exhibits 13 and 14.

JUDGE PALMER: Include premiums?

THE WITNESS: Include premium over and above the Class III milk prices.

JUDGE PALMER: And your's do not, is that right, Mr. Cryan?

THE WITNESS: I'm simply comparing Class III minimum price, fluid grade.

R. Cryan - Cross

JUDGE PALMER: Your comparisons don't hold to the premiums?

THE WITNESS: No.

Q. I see. So you're saying the comparison you made was between what and what when you are doing 2004 and 2005?

A. Between the NASS fluid grade milk prices and the Class III prices, Federal Order Class III prices.

Q. The minimum price you are saying?

A. Yes.

Q. And back in 1995 the Class III minimum price was the actual price being paid for Grade B milk; correct?

A. That is right.

Q. And now the Class III price is the regulated price instead of using the prior price formula?

A. I beg your pardon?

Q. The Class III price now is the regulated price that's set by the price formula.

A. By the price formula.

JUDGE PALMER: Do you need to

R. Cryan - Cross

introduce 13 and 14?

MR. ROSENBAUM: Yes; I think I would like to.

JUDGE PALMER: We'll receive them. Any objection over there?

MR. TOSI: Mr. Rosenbaum I know were referring to two exhibits. I think you gave us a third. I'm not sure if that is in error. Thank you.

MR. ROSENBAUM: Yes; we would like to move 13 and 14.

JUDGE PALMER: We will receive them.

(Exhibit Nos. 13 and 14 were received into evidence.)

JUDGE PALMER: Other questions? At this point you are excused. I think we have the Secretary of Agricultural here from the State of Pennsylvania.

We are going to mark your statement as Exhibit 15, and we are going to receive it even before you give it. So it's received, sir.

If you give your full name and

identification.

(Exhibit No. 15 was marked for identification and received into evidence.)

DENNIS WOLFF

a witness herein, having been first duly sworn, was examined and testified as follows:

DIRECT TESTIMONY

MR. WOLFF: Dennis Wolff, and I'm Secretary of Agricultural for the Commonwealth of Pennsylvania.

JUDGE PALMER: And you have a statement to give, sir?

MR. WOLFF: Yes, I do.

JUDGE PALMER: Which we marked and received as Exhibit 15. If you would be so kind to read from it.

MR. WOLFF: On behalf of Governor Rendell, I want to thank Secretary Johanns for extending an invitation to the commonwealth of Pennsylvania to attend today's national public hearing regarding Class I and Class II milk price formulas applicable to all Federal milk marketing areas, and for his interest in the diary industry that he expressed during our recent meeting in Washington, D.C. I appreciate the request by the National Milk Producers Federation that would help off-set lower producer price that will result from USDA's recent decision to increase the make allowance as well as increased transportation and energy costs. We are supportive of amending Class I and Class II milk price formulas as a corrective measure to help address several different concerns. This testimony will provide the Agriculture Marketing Service pertinent information to fully consider the merits of amending the federal orders. As a national issue, this will undoubtedly be a difficult decision for USDA, as myself and other Northeast Agriculture Secretaries and Commissioners discussed with Secretary Johanns during a recent meeting regarding the viability of the dairy industry in the Northeast United States.

Agriculture is Pennsylvania's number one industry, with diary contributing 42 percent of the agriculture revenues.

Pennsylvania has 8,600 dairy farm businesses that produce 10.6 billion pounds of milk annually. The income from this milk is very important to the state's economy, and this volume of milk is important to feeding the United States population on the east coast.

During the past ten years Pennsylvania has lost over 2,000 diary farms and 75,000 dairy cows. This trend has been driven by low profitability within the industry. Initiatives have been established in the state to improve profitability and there are positive results. However, those results are thwarted when milk prices decrease by 17 percent at the farm gate, as they have during this past year. The U.S. all-milk price for 2005 was $15.15 per hundredweight. Penn State Agriculture Economist Dr. Ken Bailey and others are projecting 2006 to be around $12.60. This change totally removes any farm profit level that was there in 2005 and forces most farms to operate at a loss.

Cyclical changes in the farm milk prices have been more frequent and in greater magnitude. Pennsylvania dairy producers had record low milk prices in 2002, 2003. The state's dairy farms had not recovered from that when the current cycle of low prices hit. The average cost of producing 100 pounds of milk in 2005 by the top 10 percent of farms in the Northeast was $17.47. Compare that with the projected all-milk price projected for 2006 of $12.60. Aside from the drastic difference, the cost of production for 2006 will most likely be even higher. In the Northeast, we produce only 16 percent of the nation's milk supply, yet Pennsylvania is within 500 miles of 50 percent of the United States population.

According to the USDA, the National Milk Producers Federation's proposed amendment would establish a direct relationship between dairy product prices and the Class I and Class II price. Because the cost of producing Class I and Class II milk have risen, NMPF's request would add up to 73 cents per hundredweight to the prices, resulting in higher prices for dairy farmers. It is our understanding that if approved, this amendment would add about 35 cents per hundredweight to the milk checks of producers in the Northeast and 50 cents per hundredweight in the South. As referenced previously and personally witnessed on Pennsylvania dairy farms, there is a strong interest in supporting any efforts to raise Class I and Class II prices for dairy farmers, based upon the current industry status.

We appreciate the opportunity to provide input on the need for amending the Class I and Class II price formulas and view this as an important step in strengthening milk prices for producers.

JUDGE PALMER: Is there a question? Thank you very much.

MR. WOLFF: I have just one brief comment I would like to add to this. That is a fax that's dated December the 7th, 2006. It came from an agra business in northern Pennsylvania in Canton and Bradford County. I just want to read one paragraph from his e-mail to me.

He states, "The current milk prices have a serious negative impact on the ways we must do business. Primarily the issue is cash flow. Dairy producers that have dealt with us for years cannot pay their feed bills this year. At the same time lenders that I have talked to are limiting their exposure to the access. Ultimately this will lead to a very serious situation. We have dealt with this situation by cutting employees, cutting employees' hours, reducing benefits, reducing insurance programs, increasing credit lines, delaying plant improvements and reducing costs. We think this speaks to the seriousness of the situation in Pennsylvania."

JUDGE PALMER: Thank you. We appreciate your testimony. We appreciate you being here, sir, and I think you have other business to attend to. So thank you so much.

We had a request from a Mr. Dibbell. Is Mr. Dibbell here?

MR. DIBBELL: Dibbell.

JUDGE PALMER: I'm sorry, sir. If you would come forward.

KEN DIBBELL

a witness herein, having been first duly sworn, was examined and testified as follows:

JUDGE PALMER: Take that seat. Let's get your full name on the record.

DIRECT TESTIMONY

MR. DIBBELL: Ken Dibbell, D-I-B-B-E-L-L.

JUDGE PALMER: And you have a dairy farm, I believe?

MR. DIBBELL: In Chenango County, New York.

JUDGE PALMER: Would you give the name of it and where it's located.

MR. DIBBELL: Twin Pond Farm, South New Berlin.

JUDGE PALMER: And you now have a statement which you would like to give which I'm going to mark as Exhibit 16, and we'll let you talk to it first and then we'll see about receiving it.

(Exhibit No. 16 was marked for identification.)

MR. DIBBELL: I feel obligated to give you a little bit of a bio since most of the people here have a bio. I'm a Green Mountain boy born in Foot Hills in the Green Mountain six miles south of Stall. I grew up on my uncle's farm on Stall and my grandfather's farm on Westland Stall. In spite of some of the stupid things I did along the way, I survived, graduated from high school at the ripe old age of 17 years and two weeks.

I don't have a degree in anything except hard work and realty. I went into the real world, left Vermont, became an aircraft mechanic, became a freight engineer, been on strike since 1962, at least in airlines, some of you might remember. Stayed in the airline industry and have a flight engineering and eventually a pilot. Was out of work in '76 and my boys who had worked on a local farm in New Jersey thought they wanted to go farming and we did and I'm still farming.

My second degree I got through a home study course three years after I got back into dairy, 1976, November 1. It was a home study course on juggling and felt that it was necessary to complete that course if I was going to stay in the dairy production business. Well, no matter how hard I tried I couldn't make it work. So the moment I got into the real world and had worked and farmed both it doesn't do much for your home life. I guess we might as well go ahead and read my one page statement and then add a few comments to that.

Support for Higher Class I Price. I do support a higher Class I price; however, I am having a problem reconciling what $0.73 will do to solve the pay price disaster at the farm gate. Current total economics cost per hundredweight in New York for October of '06 is determined by ERS to be $23.08 per hundredweight. That is just about $10 more than the farm gate pay price. Unfortunately, the format has been changed to eliminate the bottom line of net economic return which has been negative every year except one or two since 1980. This explains quite clearly why the nation's dairy farm numbers have declined from 250,000 in 1980 to fewer than 70,000 today, I was shocked to see the numbers down to 64, primarily to the failure of the Federal Milk Marketing Orders to operate in the real world. Farm numbers in New York have declined from 19,000 in 1980 to fewer than 6,000 today, and it is going down every day. In Wisconsin numbers have decreased from 44,000 in 1980 to less than 14,000. This is a national disaster for the royal economy, nothing less.

I moved to Chenango County, New York thirty years ago on November 1 to thriving county seats, lots of manufacturing, well run town, and now I have got five Dollar stores, a lot of empty storefronts, a Wal-Mart recently converted to a Super Center and now we have a Lowes and a lot of empty storefronts on Route Street. That is not progress. Everybody is trying to reinvent themselves.

Let's go to Supply Side Economics. Thank you Ronald Reagan and Jack Kemp. Unlimited production with no supply management gave us the buyout but still no production control and so, the economic rural disaster continue and still does. It is very easy for me to compare the FMMO system to the war in Iraq; it is about attrition and devastation. In this case, it was home grown.

If we could look back to the compact which our congress in their infinite lack of wisdom to terminate. It took three years to get a supply management thing in place and it was only there for a few months. It would have worked, could have worked, but the incompetency collectively, you know where, canceled it.

And then we come to the MILC. This program was a hoax from the beginning -- 17.40 per hundredweight was the number 16 years ago for a pay price of $14. The reduction from 45 percent to 35 percent of the difference between 16.94 and Class I price borders on treason when the percentage should have moved to 100 percent of difference of the difference to help with spiraling energy costs, taxes and insurance and everything else farmers purchase.

While we're on that subject, I'll add a little bit. The Ag Marketing Act in 1937 38 Section 608 5 C states and I quote, "No price shall be determined by feed costs and other economic factors; taxes, insurance and energy are other economic factors."

For the past 26 years we have been in this box that even Houdini could not have escaped from. Gentlemen, it is time to step outside the box and price Class I milk at its cost of production. Production close to the market is still a valid theory. That was a remote marketing understatement and a marketing act.

It is a national disgrace that our automotive industry has been forfeited to Asia and manufacturing to China. The last time I checked, our nation's position was still anti-communist. We still refuse to deal with Cuba, a country in our own hemisphere. What's the sense? The money is in the marketplace not government payments. So let's get it from there. Consumers will support fair milk prices if the money goes to the farms. Northeast retail prices are currently over $4 per gallon and the farmer isn't even getting $14 per hundredweight on the milk that is retailing at

$46 per hundredweight. Something is wrong with this picture.

Class I Fluid Milk is not a global trade item. Let the local market support the local farms with a realistic Class I price decoupled from the pool and paid out on a per farm basis within a state or a federal order. It is time to act and the time is now. Step outside the box and do something realistically relative to the Class I price. With a Heavy Heart, Your's Truly.

P.S. Throw in a flood to make cash flow even more difficult for farms in 13 counties in New York in '06. Not one flood but four, the big one followed by three slightly lesser ones.

JUDGE PALMER: Does that include your statement, sir, with the various attachments?

MR. DIBBELL: Not exactly. I would like to review a couple of pages in here. Solution: Decouple Class I milk. Use this federal order as an example. Pricing the cost of production or even slightly less, $20 a hundredweight would be reasonable, and in New York with a 200 percent a dozen amount that would be 3.45 a gallon. It wasn't that long ago they were paying $4 for gasoline with no nutrition involved. Take this order as an example. I want to give you an example. Go to page 4. Northeast Pool Total Classified Value in dollars; '04, '05 and '06. Look at September of '06 and then look at September of '05, 61 million less dollars in the same market in the same time period a year following. If that $61 million is only spent five times per year, that becomes $300 million out of the local economy. If it's spent seven times, it's $420 million. It doesn't circulate. It's being felt in rural America. Locally farmers union dealers can't sell anything. You heard the Secretary from Pennsylvania point that out. You can't even afford their labor base to have things fixed. You are up to $60 an hour. It was not that long that that was $30 and with $13 milk you could give them a little. No more. That sector is in direr straits for selling things to dairy farmers.

I would like you to go to page 2. I'm hoping to avoid a lot of questions. New York monthly dairy costs of production per hundredweight of milk sold in '06. You will notice October '06 circled on most copies, 23.08 per hundredweight cost. Seventy-seven cents isn't going to do a bloody thing to fix that problem.

Go to the next page. There is some other interesting comparisons on that page if you care to take the time. I don't want to waste your time. Now, we are looking at economic returns for the year '06 as well. Mailbox prices, New England States, August, 12.51. How does that compare to 23.08? Not very well. All federal order areas, 11.92 mailbox prices in August. A long way from $23. I don't know what John Rourke has been doing. I mean, here it is December and we don't even have September or October. He must be getting ready for retirement or maybe he is on vacation.

Sixty-one million dollars in less revenue in nine months of '06 than the same nine months in '05. How can you operate any kind of a business with those kind of numbers. I'm willing to accept an answer from anybody from the department.

I believe the rest of my testimony is self-explanatory. It's just what some would consider to be political rhetoric. Although I'm not the world's best politician. There are no good politicians. Enjoy. It will put you to sleep tonight.

Just a few other comments, notes that I made. Ice cream manufactures always whining, but they could afford to reduce the size of a half gallon to a 1.75 quart or a 1.69 liters. Now there must have been a cost involved in recreating all of those containers, recycling them.

It's my understanding that Mark Stevenson of Cornell University said we were not entitled to an increase in make allowance. Mark and I don't always agree, but on that one we agree. The money needs to come from the marketplace, not from the farmers' pockets. The fact that dairy farm producer numbers in the United States has fallen from 250 to 64,000 in the last 26 years it is a national disaster as far as I'm concerned.

Now, we come to the subject of hauling. You get into a community marketplace, provides free hauling. There is no such thing as free hauling but at least the farmer doesn't have to pay. The marketplace is paying for the haul. The mega producers enjoy free hauling. And who pays for that free hauling? It's the small farm community that's still paying the haul. Like I repeat, there is no such thing as free hauling. The mega producers have no hauling charges. That money comes out as hauling charges from the nonorganic farmers.

And then we come to an RBGH free premiums. They are there in the marketplace, but they are sure having trouble finding their way to the farm. The public recognizes that as a superior product versus conventional milk today.

As a side note, somebody did a study. America Medical Association endorsed it. Twenty has increased four-fold in the last ten years in the general population. That trend is IGF1. Some people may enjoy twins, some would enjoy just having a single. Farm Net in New York, that's the organization that tries to keep people farming. Five thousand phone calls from 6,000 farms in the past four months trying to find a way to survive. Suicide rate, was unable to get a handle on the number just in New York tracked by NCAMG, New York Agricultural Medical Group. I will get the numbers. Divorce rate in the dairy farm community spiraling upwards. If you can't afford to farm, you sure can't afford to divorce. The responsibility for this mess lies right in this room, a major portion of it. It's time to get out of the box. Take a look at reality and tell me how to pay $23 at cost with $10. I tried it. I had to go back in the real world and pay for the farm, and then, as a matter of fact, I'm going to tell you I got awarded once, Conservation Farming of the year, Chenango County, New York, 1992. That farm went into the ground. Seven acres of it washed away to 2706. I inherited 66,000 cubic yards a grout that I really didn't need. It's all been moved to fill the holes.

I think I probably will quit at this point. I will be delighted to entertain questions, and I'm just thankful that I don't have a degree in Ag economics from Florida State, Penn State or Cornell University. My degree is in reality. Thank you.

JUDGE PALMER: Are there questions? I think you covered it fully for everyone. Thank you very much. Thank you for coming in.

MR. DIBBELL: Thanks for having me.

JUDGE PALMER: Let's go off the record.

(Discussion held off the record.)

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

MR. HARNER: Tim Harner representing Upstate Niagara and O-AT-KA and Bill Beeman has some testimony.

WILLIAM BEEMAN

a witness herein, having been first duly sworn, was examined and testified as follows:

JUDGE PALMER: He's sworn, and if we get his full name, we'll start with him.

MR. HARNER: Give your name.

MR. BEEMAN: My name is William Beeman.

MR. HARNER: Did you prepare testimony today?

MR. BEEMAN: Yes, I have.

MR. HARNER: May it be marked as Exhibit 17?

JUDGE PALMER: Do you have a copy?

MR. HARNER: Yes. Please proceed to read it.

(Exhibit No. 17 was marked for identification.)

DIRECT TESTIMONY

MR. BEEMAN: My name is William Beeman. My wife and I operate an eighty cow dairy farm in Pennsylvania. We are members of Dairylea Cooperative. I serve on the board of directors as its first vice president and secretary. My business address is RR 2, Box 131, Kinsley, Pennsylvania.

I appear here today on behalf of 2,400 members of Dairylea Cooperative who urge the Secretary to implement the National Milk Producers Federation proposal to update the Class I mover. This is needed to increase cost of production and other factors. Dairylea also supports the change of Class II pricing as proposed by National Milk.

Additionally, Dairylea request that a decision be implemented on an emergency and expedited basis. Dairylea is a member of National Milk who supports its testimony. Dairylea also supports the testimony of the Association of Dairylea Cooperatives of the Northeast for which Dairylea is a member. Dairylea extends its gratitude to the Secretary Johanns for quickly responding to letters from Dairylea, National Milk, other cooperatives and individual farmers who are calling this hearing.

Since Federal Order Reform was implemented in 2000, there has been a pool in bust cycle and milk prices. The following graft show the monthly blend price from January 2000 to October 2006 for Order No. 1 adjusted to Central New York area, i.e., minus $0.75 per hundredweight from Boston.

The Order No. 1 blend prices is the base price perceived for Dairylea membership.

During this time there were record high blend prices in '01 and '04 and very strong blend prices in '05. The other years milk prices have been very low.

It has been my experience, and in general the experience of the Dairylea members, that the '01 prices allowed myself and Dairylea members to make up for losses and increased borrowings from the low prices of 2000. The '04 and '05 price levels helped members get back to even for the long price depression during most of '02 and '03. The low prices of '06 have again put my farm and other Dairylea members in a hole and forced farmers to significantly increase debt levels to make up for the operating losses. On my farm, the Milk Income Loss Payments have helped but have not added enough revenue to make up for the low blend prices.

This pricing cycle is much worse than those in the past because of the significant increase in the number of key input prices that have resulted in a much higher cost of producing milk. On my farm, higher energy related prices have dramatically increased prices for such things as diesel fuel, utilities, fertilizer and corn drying costs. Additionally, just about everything we buy has a fuel surcharge added to it. Additionally, interest rates, hired labor wage rates and health, workers comp, fire, auto and liability insurance costs have increased. Presently, my cost of production is $16.51 per hundredweight. This is $3.21 higher than it was in '02. The combination of these higher costs and low milk prices have made this down cycle much worse than in the past, far worse than '02 and '03.

I believe that the resulting financial crisis that is occurring due to the high input prices, the low milk prices that is affecting dairy farmers across the country. Attached to the table from the United States Department of Agricultural Economic Research Survey. It identifies U.S. milk production costs since Federal Order Reform. Between '02 and '05 total operating costs have risen $1.56 per hundredweight total cost listed increase by $2.43. On my farm, cost of production increased even further during '06, as I suspect it did on most farms throughout the country.

For most of '06 I could produce feed at relatively inexpensive prices. For instance, I was buying feed at $208 per ton. Now feed bill is $260 per ton, a 26 percent increase. I am anticipating much higher feed prices for 2007 due to the growth and economic production which is being promoted and subsidized by the federal government. At the same time I am not expecting input prices for other factors to decline very much. Although the price forecast I have seen show improved milk prices for '07 of about $2 per hundredweight, the increases do not appear to be large enough to cover the increase costs and at the same time make up for losses in '06.

Compounding this would be a lower blend price which and will occur due to the implementation of the increased Federal order make allowance. Ed Gallagher, Dairylea as vice president of Economics Risk Management has estimated that make allowance will lower borderline blend prices by $0.23 per hundredweight during '07. This will be an additional $3,100 decline of revenues on my farm in '07. For Dairylea members in total it will be a 12.4 million loss in revenue.

Dairylea respectfully request the Secretary to adopt the National Milk proposal on a basis to offset a higher cost in producing milk in the market.

Thank you for allowing me to testify.

JUDGE PALMER: There is a table attached. Are you going to explain the table?

MR. HARNER: Yes, and I would ask that his testimony, including the table be admitted.

JUDGE PALMER: Yes. It's received.

(Exhibit No. 17 was received into evidence.)

MR. HARNER: I don't have any questions.

JUDGE PALMER: Are there any questions? Does everybody understand the table? I gather the table -- let me ask this. The table is from a government reporting?

MR. BEEMAN: Yes.

JUDGE PALMER: It says U.S. Milk Production Costs and Returns 2000-2005 -- actually, isn't that similar to the one we already received, Mr. Rosenbaum?

MR. ROSENBAUM: Yes; it's the same table.

JUDGE PALMER: No problem with that. Any questions for the witness? There doesn't appear to be any, sir. Thank you very much. Who next?

MR. HARNER: I would like to

have Mr. Scott Herring who is a witness from the Northeast Farm Credit Associations.

JUDGE PALMER: We're going to take him as the last witness of the morning. Then we'll break for lunch. We will mark your statement as Exhibit 18.

(Exhibit No. 18 was marked for identification.)

SCOTT HERRING

a witness herein, having been first duly sworn, was examined and testified as follows:

MR. HARNER: What's your name?

MR. HERRING: Scott Herring.

MR. HARNER: Have you prepared testimony today?

MR. HERRING: I have.

MR. HARNER: And it's been marked as Exhibit 18, including your tables attached to it; correct?

MR. HERRING: Yes.

MR. HARNER: I will now have him read his testimony. After that I will offer to put them into evidence and offer Mr.

Herring as an expert in the area of his testimony.

DIRECT TESTIMONY

JUDGE PALMER: Spell your last name just to make sure we have it right.

MR. HERRING: H-E-R-R-I-N-G, just like the fish. Thank you. As you've heard today from a number of witnesses, Northeast Dairy Farmers have experienced very difficult operating conditions for entire 2006 operating year. Farm milk prices have plummeted to levels well below the cost of production. Also, cost of production itself has been under substantial upward pressure as a number of costs, including anything closely related to the energy complex, such as trucking and utilities, interest costs and now feed cost have seen substantial upward pressure. In addition to these market activities adversities, some regions within the Northeast have experienced cropping adversity with heavy late spring rains delaying and even at some points prohibiting the corn planting and interfering with early summer forage harvesting. All of this adversity speaks to the need to reconsider Federal milk marketing order price formulas as to any possible ways to update them to benefit dairy producers.

I'm here representing COBank Northeast Regional Council and more specifically the four Farm Credit associations who collectively serve the eight states of the Northeast: Farm Credit of Western New York, First Pioneer Farm Credit, Yankee Farm Credit and Farm Credit of Maine.

Collectively these four associations provide nearly $1 billion of credit to approximately 4,500 dairy farmers in our region as of the end of 2005, and this accounts for more than half of the total credit used by dairy farmers in the region. In addition, we provide a variety of other services to dairy producers, including accounting services, consulting, leasing, crop insurance and appraisals.

Currently I am employed by the Farm Credit of Western New York as chief operating officer, a position that I've held since 1998. I have spent thirty years working with Farm Credit and farmers in the Northeast as a loan officer, credit analyst, credit manager and chief credit officer. Also, the past credit in the Northeast Cooperative Council, and I currently serve on the Northeast Dairy Leadership, a team of dairy leaders from New York, Pennsylvania, Vermont, formed to collaborate on dairy issues facing in each state and the Northeast milkshed collectively as dairy policy is considered in the future. In my current capacity I serve as Chief Financial Officer, Chief Credit Officer for the Farm Credit of Western New York. In this capacity I have substantial daily insight into the dairy farm customers; actual farm operating conditions.

Starting in 1978 our associations have annually prepared a detailed report on farm operating conditions called the Northeast Dairy Farm Summary. This is a statistical summary of actual farm accounting records submitted by several hundred of our customers for tax and credit purposes. Our staff works closely with participating producers to obtain balance sheets and income statements, to reconcile the data and to obtain additional data such as the average number of cows and otherwise prepare the data for use in our annual summary. A profile of that summary is listed. We have 539 farms from across seven of the Northeastern states. The average size farm is 232 cows, 577 crop acres, there are five workers on the farm producing an average of 21,593 pounds per cow. Milk price received in 2005 was $16.12. There was $590,000 of debt and that resulted in a 72 percent net worth.

Now, this is a representative sample of the Northeast dairy industry that is very useful for studying year to year trends and differences in cost profitability and cost factors among individual farms. It is not intended to be a complete analysis, nor is it a random sample of all dairy farms in the Northeast. Although we believe the data is the most indicative set of data available for studying Northeast dairy farms over a long period of years and it's now been 28.

For purposes of this testimony, we're going to present data from 1990 to the present, including our best estimate of 2006, and that estimate was actually developed by my colleague, Mr. Jim Putnam, First Pioneer Farm Credit. In showing these 17 years, it's our intention to provide a historical context of numbers that includes the 1996 through 1998 baseline period that was used in the 2000 Federal Order changes.

There has been a substantial cost inflation being experienced by farmers in 2006, and for that reason it's critical to include the estimated 2006 results. Our estimate was based on the following factors: We took the 2005 cost of production, broken down by the 18 individual cost categories that we have in our Northeast Dairy Farm Summary. Then we changed each individual category by a percent change in the input cost index published by the USDA monthly during 2006.

Then we adjusted each individual cost category for the increase in milk production per cow, again as reported by the USDA number in its publication called Milk Production. That resulted in a one percent per cow gain in production in our eight state region and has the effect of offsetting cost inflation by that same amount. So the cost was actually tempered by the amount of production that were shown in the data.

From that data we then constructed a cost series that we are calling Labor, Resource and Utility expenses which attempts to track costs of Grade A milk production referenced in the 2000 Federal Order proceedings as well as testimony submitted by other proponents of the present petition. This series included the following cost categories, had to hire labor, insurance, interest on debt, repairs, supplies, taxes, utilities, veterinary, and medicine and milk, any other expenses that were not specifically categorized.

There is a graft on page 4 which shows what the cost factors were in that category of expenses from 1990 to 2006, and then along with that, it shows a percent change in each year on a graft below.

Based on what this data is telling us, we can make the following conclusions about Labor, Resource and Utility expenses.

This combination of expenses, first of all accounts, for a little over half, 55 percent of total cash operating expenses in both '05, '06, and it's accounted for an average of 54 percent of the total expenses since 1990. So it's a significant portion of the expenses.

The general category of non-feed, non-crop production cost does not show a steady year upward progression but rather fluctuates quite a bit from year to year. This is not a surprise as dairy farmers are continually challenged to manage around a large array of external factors that continually influence their cost of production.

The general trend within this price series has been upward and it is dampened considerably by continual increases in milk production per cow which have the effect of offsetting pure input of costs.

Comparing the 2006 estimated Labor, Resource and Utility costs of production with a baseline period of 1996 to '98 shows a 23 percent increase.

Looking at just a change since 2003 shows that cost inflation just in the past three years is 18 percent.

In addition, that trend over time has been for the Labor, Resource and Utility costs to increase with general inflation, but there have been periods like 2002 and 2003, and if you look, those are extremely low price years as well where the expenses did decline somewhat. So what might we anticipate in 2007 and 2008? Looking forward our view is that continues to be a substantial upward pressure on this category of costs which would likely keep it at 2006 estimated levels and probably modestly higher in the next couple of years. The rationale behind that thinking is that labor, the largest component of this category, is likely to continue to rise, along with prevailing wage rates in the economy. Several Northeastern states have already raised the minimum wage, and there seems to be a fair likelihood of a Federal increase when the new congress comes in next year.

Interest rates have been at historically low levels, as the Federal Reserve tries to manage recession and impact of 911 attacks, and while we may have peaked out in the current cycle, no one that I know is forecasting a near or a sharp reduction in interest rates in the coming year. Most dairy farmers are drawn extensively on their operating lines of credit as a result of this year's operation to help pay for bills. So the prospect is that they are entering into 2007 with higher levels of debt on which the interest is incurred.

Energy costs have backed off somewhat in the past last six months, and this is reflected in the USDA cost indices. Again, no one that I know of is forecasting a return to $1.35 gas, and today's energy-driven costs are here to stay and have a substantial impact on dairy farmers' cost structure in areas such as utilities and other services.

We also looked at the hauling costs paid by dairy farmers which are a separate category to the overall cost accounting approach. Given the hyperinflation of fuel costs in the last couple of years should come as no surprise that Northeast dairy farmers have experienced substantial inflation in this category as well. Up 63 percent from the baseline period through '96. Since this cost is on a per hundredweight basis and is passed back to the producer with basically no opportunity for cost control, it's not surprising to see this trend, and then I have got a separate chart to show data on just the hauling and freight charges for dairy farmers.

In summary, Northeast dairy farmers have experienced a substantial cost of inflation in their business in the past three years. We calculate this to be 23 percent in the Labor, Resource and Utility cost category and 18 percent in just the past three years. This would have been a substantially larger percentage increase and has not been for the continuing gains in efficiency that the producers have been achieving. We support all of the efforts to updating the pricing provisions of the Federal marketing orders to properly reflect today's cost realities back to dairy producers, and I thank you for the opportunity to present this testimony today.

MR. HARNER: Thank you. Just for clarification, there is a loose sheet tucked into Exhibit 18 that should be part of Exhibit 18.

JUDGE PALMER: Mine has it stapled.

MR. HERRING: I will caution because there are a number of spreadsheet items in there. The operative spreadsheet is the long one. There are a couple of copies I think of details within this spreadsheet that don't necessarily run you all the way through it. It's just a mistake relative to the printing process of those. So the one chart with all of the 18 categories and the per hundredweight breakdowns on the long sheet really is the operative spreadsheet on that exhibit.

S. Herring - Cross

CROSS-EXAMINATION

BY MR. HARNER:

Q. There was one place I thought I heard you misspeak towards the bottom of page 5 where the text says talking about substantial inflation in fuel cost up 63 percent between the 1996 to '98 base period in 2006, and I think you said through '96, but you intended what is typed in your testimony; right?

A. I did. Between the baseline period and 2006.

MR. HARNER: I would ask that Exhibit 18 be admitted into the record and Mr. Herring be recognized as an expert.

JUDGE PALMER: It's received, and he's recognized as an expert in farmer financing, I gather. Any questions for him?

(Exhibit No. 18 was received into evidence.)

JUDGE PALMER: Let's break for lunch and we will be back at 1:15.

(At this juncture, a luncheon recess was taken.)

JUDGE PALMER: Back on the

S. Herring - Cross

record.

CROSS-EXAMINATION

BY MR. ROSENBAUM:

Q. Steve Rosenbaum with the International Dairy Foods Association.

Mr. Herring, if I could ask you to turn to the last page of your exhibit which is Exhibit 18 which is the 3 1/2 by 14 spreadsheet.

A. Yes.

Q. And what I would like to start by focusing on is the column that's called Labor, Resource and Utility. Do you see that column?

A. Yes.

Q. Now, is that a phrase that is used commonly in your business?

A. Not particularly, no. I would say that it was something put together to try and match up with what would have been done in 2000 with the Federal market order changes that were made.

Q. Because that is the phrase that was used in the 1998 decision, not decision, proposed rule; correct?

S. Herring - Cross

A. I believe so. I'm not exactly sure of that, but I believe so.

Q. What I see here is -- what I would like to do is make a comparison between 1996 to '98 average and that same Labor, Resource and Utility figure for 2005. And are you saying that the 6.46 number to the $7.52 number?

A. Yes.

Q. Are you aware of the fact that the proponents have actually based one piece of their claim for higher Class I price based upon a comparison based upon that comparison?

A. I was not aware of that.

Q. Let me actually make it even a little more pointed. If you have the 1998 number, that's $6.95; correct?

A. Yes, or is that 99?

Q. I thought that was the '98 number.

A. $6.71.

Q. 6.71. So 6.71 is the 1998 number?

A. Yes.

Q. And 7.52 is the 1995 number; correct?

A. Correct.

S. Herring - Cross

Q. And the difference between the two I get as $0.81?

A. That looks right.

Q. So as a percentage, in terms of what the percentage increase is it would be 81 divided by 6.71; correct?

A. Correct.

Q. Can you tell me what that is?

A. No. I don't happen to have my calculator with me. So you might be able to tell me better than I can tell you.

Q. I get 12.1 percent. Does that sound roughly right?

A. If that's what your calculation says, yes.

Q. Have you read the testimony of Dr. Cryan?

A. I have not.

Q. Well, I will just represent to you that his figure which purports to calculate the change in labor, resource and utility expenses -- well, he purports to show a 38 percent increase and yet you only show a 12 percent increase. Do you have any idea why

S. Herring - Cross

that would be?

A. The only thing I know is that these are the numbers that we get from farmers' operating statements, and I don't know how his number was calculated.

Q. That is a massive difference, don't you agree, 12 percent versus 38 percent?

A. It could be, but, again, I don't know where his number came from.

MR. BROSCH: Your Honor, let the record reflect that questions based on the premise that is not exactly accurate, the record will show that the correct representation of Dr. Cryan's testimony is on page 9 of his exhibit.

JUDGE PALMER: The report is page 9. I don't know if you want to redirect your thoughts. You can stay where you are.

MR. ROSENBAUM: That wasn't what I was asking questions from.

JUDGE PALMER: You have to argue on brief.

MR. BROSCH: Just let the record reflect that.

S. Herring - Cross

Q. If I could then ask you to turn to the -- well, it's not a numbered page. It's the page of your testimony that has a column that says cost of production and then next to that it's cost of production, plus return on equity.

A. Yes.

JUDGE PALMER: That is the very first attachment?

MR. ROSENBAUM: Yes; it's the very first attachment. It comes right after the page that's numbered six.

Q. Do you see that?

A. Yes.

Q. Now, I take it that this is an effort to show what the change has been in the total cost of production?

A. Yes, and that's actually under methodology that we use in our summary which takes total cash, adjusted cash, operating costs, adds depreciation, takes out family living expenses and then also takes your reduction in that number based on the non-work income that is available to the farmer to pay a

S. Herring - Cross

portion of the property expenses.

Q. But this is an effort to try to track what the total cost of production is with the adjustments you just described; correct?

A. It is what those numbers would be reflected on the spreadsheet at the total level but not necessarily the labor, resource and utility numbers that were a part of the testimony.

Q. The cost of production figure on this page covers a broader set of inputs than merely labor, resource and utility; is that right?

A. That is correct.

Q. Let me ask you if I could to try to see if we can make the same comparison between the 1990 -- well, let me take a step back. Can you tell me what you are then capturing through this column that starts with $1.60 in 1990?

A. That was actually an attempt to put something in for return on equity, and actually when we finally decided to put the testimony in, that really wasn't relevant because it assumes things on kind of the structure and

S. Herring - Cross

balance sheet that may or may not be appropriate. So it was not intended to be a part of the testimony that we submitted. It was a part of the column with some of the numbers that we had run on on our spreadsheets but not apart of our testimony, because there are too many assumptions that would have to go into that number.

Q. Let's focus on costs of production, and let's make the comparison, if we could, once again between 1998 and 2005, because that is the comparison upon which Dr. Cryan's testimony rely. I'm not suggesting he was looking at the exact same inputs, but those are the two time periods he was looking at. And 2005 were at $14.55; correct?

A. That is correct.

Q. In 1998 we were at 13.82; correct?

A. That is correct.

Q. And I get that to be a difference of $0.73. Does that make my math right?

A. I'm not sure. If your calculator says that, I guess that is a pretty good number.

S. Herring - Cross

Q. I calculate that to be only a 5.2 percent increase in total production cost for the period from 1998 through 2005. Does that seem right to you?

A. That would be what these numbers say, yes.

Q. And these numbers are based upon what kind of data source?

A. Like I said in the testimony, it's 500, I think in this case 530 some odd dairy farms with their accounting records.

Q. Do you make an effort to obtain a representative sample?

A. Not necessarily, no. It's those that have the information available at the time that we put the study together.

Q. Do you believe 539 farms to be a robust sample?

A. That is a pretty good sample for Northeast.

Q. And 2005 is the last year for which we have actual data; correct?

A. That is correct. 2006 is based on an estimate.

S. Herring - Cross

Q. By the way, the next page is where you show what adjustments you make to come to the $14.55 net cost of production; is that right?

A. That's right.

Q. And what you've done is you've adjusted for the fact that farmers do obtain non-milk income; correct?

A. That is right.

Q. Is that things like selling --

A. Cattle, other types of income.

Q. So that 14.55 is the net figure?

A. That is right.

Q. If I could have you turn to page 3 of your statement. Let me correct that, page 2 of your statement, and I'm looking specifically in your discussion of the average characteristics of these farms that are a part of the survey. You show that they have $590,000 of debt; correct?

A. On average, that is right.

Q. And 72 percent net worth; correct?

A. On average that is correct.

Q. Now, am I correct that to calculate

S. Herring - Cross

the average total assets you divide $590,000 by .28.

A. It's actually taken from the actual balance sheet information. So it's the average of whatever the raw data is. So it's not necessarily that that formula is the one that you might use in order to get that number.

Q. Well, when you say it's 72 percent net worth, does that mean that $590,000 of debt represents 28 percent of total --

A. Assets.

Q. -- assets?

A. You could assume that.

Q. I think it's true then that -- correct me if I'm wrong -- if the $590,000 of debt is 28 percent total assets, then total assets has got to be 590,000 divided by .28; isn't that right?

A. That would probably get you the number. I don't actually happen to have that number with me, and it's not a part of what I put into the analysis. So I don't have that number right off the top of my head.

Q. But doesn't that have to be the case

S. Herring - Cross

if $590,000 is 28 percent of total assets, then it just has to follow that total assets are $590,000 divided by .28?

A. I think that would get you the number.

Q. Once again, we can make sure my math is right. But that produces for me 2.1 million dollars of total assets on average for these farms.

A. If you would make that division and multiply that number of cows because that is a per cow number, $2,523 per cow?

Q. No. I'm just using the $590,000 of debt?

A. Oh, that is probably a good number. I would guess that probably is right.

Q. So if one then wanted to calculate what the net worth was of these --

A. You would subtract two more.

Q. And that would leave you then with 1.5 million dollars of net assets?

A. Net worth.

Q. Net worth on average of these farms; correct?

S. Herring - Cross

A. If that's what the math comes out to be, yes.

Q. That is like 15 times the average household net worth in this country?

A. I'm not sure of that number either. And again, I don't know if it's relevant relative to these analysis we did here.

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

JUDGE PALMER: Any other questions? Mr. Vetne.

CROSS-EXAMINATION

BY MR. VETNE:

Q. Good morning. My name is John Vetne. I represent several cooperatives and organizations in the Midwest.

As I understand your testimony, Mr. Herring, the numbers in your grafts and tables are derived from an annual publication called the Northeast Dairy Farm Summary?

A. That is correct.

Q. Do you have any copies of that Northeast Dairy Farm Summary with you?

S. Herring - Cross

A. I have one with me but not for distribution, just one. They are available, though.

Q. They're pretty expensive, aren't they?

A. For a fee. They are pretty cheaply.

Q. The Northeast Farm Credit Associations are in the business of loaning money to dairy farmers and cooperatives?

A. Not typically cooperatives, no.

Q. To individual dairy farmers?

A. Yes. Basically, that is a customer base, not just dairy farmers. Anybody that would be in the production of agriculture.

Q. Agriculture production?

A. Right.

Q. Well, what portion of the banks collective business is dairy?

A. Of the four associations that I talked about here?

Q. Yes.

A. Probably just about 40 percent would be my guess would be in dairy.

Q. And is that the largest single

S. Herring - Cross

component?

A. Yes, collectively it would be the largest, and it varies by organization, depending on where you are. New England would be different than Vermont, New York different than Southern Berlin.

Q. One of your interests in appearing here is the financial well-beings of producers that owe money to the banks?

A. That would be an accurate statement. We're always interested in the financial conditions of our customers.

Q. Your financial situation is important in their ability to pay back the loans?

A. Absolutely.

Q. The Farm Credit Banks have on prior occasions given testimony on milk pricing policy issues. Are you familiar with them?

A. I am not familiar with prior testimony, no.

Q. Are you familiar with the fact that Mr. Putnam in particular has given testimony both to congress and to regional and state

S. Herring - Cross

representatives?

A. I don't know what Mr. Putnam did.

Q. Is this your first time doing this kind of thing?

A. Yes, it is.

Q. Good work. The published Northeast Dairy Farm Summary, at least the last time I sprang for a copy, contains information dividing producers by quartile groups of efficiencies and costs; is that correct?

A. That is correct.

Q. And it still does that?

A. It still does.

Q. And on occasion I'm aware, let me ask if you are, the banks have further subdivided production costs and farm efficiency into docile groups. Are you aware of that?

A. I have not seen that information. So, no, I don't know that. I don't think that is a part of our normal publication.

Q. No. I'm referring to a presentation derived from the data presented by Mr. Putnam to congress in connection with the 1990 Farm Bill.

S. Herring - Cross

Are you familiar with any subgroupings that are larger than quartile groups of producers for cost?

A. Only the one that would be the whole.

Q. And that's what we have here? This is the whole?

A. Correct.

Q. Which is the weighted average?

A. No. It would be the per hundredweight cost of all of those that were included in that group. It's not weighted.

Q. Where you assign a cost to each hundredweight produced for each producers?

A. Yes.

Q. And your aggregate of all the hundredweights?

A. Yes. It would be based on what the dollars spent by the total balance produced.

Q. With respect to the quartile analysis with which you have some familiarity, what is the typical range between the lowest cost and the highest cost quartile groups and total costs of production?

S. Herring - Cross

A. As it relates to the labor, resource and utility?

Q. As it relates to all costs.

A. Probably between 10 and $20 would be in that range.

Q. From the low quartile to the high quartile?

A. Yes, if you were to base that just on pure costs.

Q. And pure costs in your response meaning what?

A. The net cost production numbers that are shown there on some of the attached data.

Q. Is that after page 6?

A. Yes, after applying the non-milk income.

Q. Go to the end of your written statement. There is an unnumbered page that has a column, the first column is years, the second column is cost of production.

A. Right.

Q. And the 10 to $20 range of quartiles applies to the first column?

A. Yes.

S. Herring - Cross

Q. With respect now to going to the subcomponent of costs entitled labor, resources and utility, are you aware of any information on how the range of that category of costs would be in the quartile grouping?

A. No.

Q. Is that something that is not ordinarily published?

A. That is right.

Q. And you haven't done the numbers?

A. I have not.

Q. Would it be fair to say that the significant factor entering into the range of 10 to $20 between quartile groups would be these costs?

A. I don't know that I could make that assumption without having done the calculations.

Q. So you don't know whether it does or doesn't?

A. No, I guess I don't, because there are other fairly significant cost categories that might apply to that.

Q. Such as?

S. Herring - Cross

A. B.

Q. B, costs change?

A. By operation they could change.

Q. And they change by, for example, milk price?

A. I don't know it's distributed as much by milk price.

Q. Are not some feed options more expensive for producers?

A. Yes.

Q. And aren't producers more likely to select those feed options when milk prices are good?

A. I don't know. That is an individual management decision. So I'm not sure I can make that decision.

Q. And you don't know how your data would reflect that kind of choice?

A. I do not know that.

Q. Let me see if I can figure this out. Looking at the supplemental spreadsheet here. If a producer in any year decides to purchase new equipment rather than repair old equipment, where would the costs of the acquisition appear

S. Herring - Cross

in these columns, if anyplace?

A. They would not be in there.

Q. Would you agree with me that producers tend to acquire new equipment to make capital improvements during the years of good milk prices and maybe appear during lower milk prices periods?

A. Again, a management issue. I'm not sure that you can paint it with a broad brush.

Q. You don't know how your data --

A. No; I don't know that.

Q. Are there any comparable, any publications comparable to the Northeast Dairy Farm Summary that's sponsored by the Farm Credit organizations elsewhere in the country?

A. I don't believe so. If there are, I'm not aware of them.

Q. In response to some questions by Mr. Rosenbaum, you made reference, I think it was to the procedure or assumptions or process that you use, the banks use to calculate return on equity and some improvement costs, family living. Do you know how your methods differ from those employed by USDA or the State of New

S. Herring - Cross

York, for example, in their --

A. No; I don't know that.

Q. You don't know how they do it?

A. No.

MR. VETNE: That's all the questions I have.

JUDGE PALMER: Other questions? Mr. Yale.

CROSS-EXAMINATION

BY MR. YALE:

Q. Good afternoon. My name is Ben Yale. I'm here on behalf of Select Milk, Continental Dairy Products and Dairy Producers New Mexico.

Your testimony that you've given here, you are not an expert in dairy policy in terms of how pricing is done; is that correct?

A. That's correct.

Q. And your position is is that for the viability of the dairy farmers in short they just need more money for their products. That kind of sums up what you are saying?

A. Well, I guess my position would be

S. Herring - Cross

that if, in fact, part of the milk pricing formulas are cost related, that this evidence was at least indicated that there is a trend in increasing cost and that that could be relevant in making decisions about what milk price formulas could be.

Q. But you're not picking on one particular formula or another. It's just in general what you're saying?

A. That's correct.

Q. And this could apply to any class of milk that would be appropriate to adjust and to gain some relief to offset these higher costs?

A. I guess I wouldn't say that I know enough about milk prices to say yes to that. So I guess I don't know.

Q. But to the degree you do know is that you are not telling the department where to find those places in the formula?

A. No.

Q. You are just telling them it would be a good deal for the dairymen in your region to --

A. That is correct.

S. Herring - Cross

Q. And that that also has a direct bearing on the farm credit systems that is an integral part of rural New England; right?

A. Yes.

Q. And that availability of that credit is not just the dairy farmers; right?

A. That's correct.

Q. It's a whole range of agricultural projects; is that correct?

A. Right.

Q. Including cooperatives; right?

A. Not through the local association. That's not a good coop.

Q. But the distress on the part of dairy farmers can have an impact in the farm credit system and its ability to work with other farm commodities as well?

A. It could. Again, it depends on your concentration on dairy and whether or not that might have a significant enough impact on your organization.

Q. And the magnitude of whatever?

A. That's correct.

Q. But it has an impact on just beyond

S. Herring - Cross

the dairy industry pricing of what you're asking?

A. It may.

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

JUDGE PALMER: Any more questions? Yes, sir.

CROSS-EXAMINATION

BY MR. WELLINGTON:

Q. Bob Wellington with Agri-Mark Dairy Cooperative.

Mr. Herring, does the Farm Credit Associations that you represent do they loan money to any farmer who asks for money?

A. No.

Q. So you have a set of criteria that the farm has to meet?

A. That is right.

Q. Can you explain those criteria that you use?

A. Well, I would tell you that each individual organization is slightly different. So they are not exactly the same as far as to

S. Herring - Cross

what the underwriting standards could be. We have regulations that govern what we could do relative to owing a real estate. So we have to stay within the parameters there, but ultimately it boils down to what the payment capacities and operation they have in order to repay the debt, and typically we have three or four criteria that they need to meet the working capital relationship, a net worth relationship, and a debt coverage type relationship would typically be where we would be in looking at loans.

Q. So typically if a farm does not satisfy these criteria, you would not give them a loan for farm credit?

A. That's correct.

Q. So such a farm would not be included in this summary?

A. That's probably right. I don't think -- there could be farms in here that actually don't have any relationship with us because they may have financial service relationships with us. So it's possible that they don't borrow from us but still could be

S. Herring - Cross

included in this summary data.

Q. Do you believe that the farms in this summary tend to be better managed than the average farm just because they keep these type of records?

A. I would say they are.

JUDGE PALMER: Any other questions? Just to make sure I have got all of the housekeeping properly. I didn't put down a couple of receive marks next to some statements. So to be on the safe side the statements that are contained in Exhibit 16, 17 and 18 are herewith received.

Do you have questions, sir?

(Exhibit Nos. 16, 17 and 18 were received into evidence.)

CROSS-EXAMINATION

BY MR. DIBBELL:

Q. I would like to hear your opinion of what the solution to the dairy farm gain price problem is? Do you have an opinion?

A. I guess if I was to think about that here today, I don't. I have not given that thought to the purposes of this meeting and this hearing. So that part I will stay away from because I really have not given that a thought to be able to respond to that.

MR. DIBBELL: Thank you. Your Honor, I would like to share a lighter moment with you, if possible, without being out of order.

JUDGE PALMER: Off the record?

MR. DIBBELL: Off the record. It can go on the record. I don't care.

JUDGE PALMER: Off the record.

(Discussion held off the record.)

JUDGE PALMER: Back on the record. Are there any other questions for the witness? Thank you very much. You are excused.

TIM HOOD

a witness herein, having been first duly sworn, was examined and testified as follows:

DIRECT TESTIMONY

JUDGE PALMER: Give your full

name and identification.

MR. HARNER: What's your name?

MR. HOOD: Tim Hood.

MR. HARNER: Have you prepared some testimony for the hearing today?

MR. HOOD: Yes, I have.

MR. HARNER: Could that be marked as 19.

JUDGE PALMER: It is so marked.

(Exhibit No. 19 was marked for identification.)

MR. HARNER: Could you please read it at this time.

JUDGE PALMER: Go ahead and start, Mr. Hood.

MR. HOOD: My name is Tim Hood. My address is 41488 County Road, Paw, Michigan. I am a fourth generation dairy farmer from Southwest Michigan. My wife Debbie and I have four children. They range in age from 15 to 21 years of age and each has their own responsibilities on the farm. My father is still active at age 80 and still does most of the fieldwork. I was raised on this farm, and I live across the road from where I grew up. Our farm has grown over the years to the 400 cows we milk today. The family aspect of our farm is as strong today as ever.

I serve as a director for the Michigan Milk Producers Association. I have also served in various other leadership roles and on numerous committees. I do not claim to be an expert on Federal Milk Marketing Orders or am I prepared to answer technical questions. What I am here to tell you is how the current system impacts our family dairy farm and why I think the National Milk Producers Federation proposal to adjust the Class I and II milk prices formulas will help my family on into the future.

I have been a dairy farmer for 29 years. In that time I have seen several up and down cycles in the price of milk. Each time the milk turns down, we tighten our belts and struggle until better days. We have learned how to be more efficient and cut costs as we go through each one of these down cycles. The costs we have tried to absorb in the last year and a half have been the most difficult. The raising price of fuel has just exploded through all of our normal expenses, as businesses we deal with have passed on fuel surcharges and rate increases to deal with their rising fuel costs. Our milk hauling rates have increased 20 percent in the last year. The purchased feed and commodities we buy to feed our cows now carry fuel surcharges. These add $150 to $300 to a load of cotton seed brought in. Veterinarians, equipment dealers, custom operators all have added fuel surcharges to their bills. Fertilizer and utility bills have also been impacted. These costs are not the normal market cycle that goes up and down. They are here to stay. This has all come upon us during this last downturn of milk prices. It has been very difficult for us to absorb.

Our cooperative recently voted to approve the tentative final decision that will increase the Class III and IV make allowances. It is my understanding that the impact of this action will be to take income from dairy farmer milk checks. I do believe this is necessary in order to assure that balancing facilities will continue to exist in our local market. These facilities provide a valuable service to us as dairy farmers, and our creditors, by providing assurances that we will have a market for all the milk our farms produce. Their existence depends upon them being profitable. Our cooperative operates two balancing plants in the Michigan market, and, as a board member, I have seen the impact of increasing operating costs and the declining profitability of these two plants.

I reluctantly accept the impact on my returns for Class III and IV milk. It is unfair and unrealistic though to expect dairy farmers to expect less money from processors of Class I and II milk. I understand the changes contained in the tentative decision. We will soon see a $0.25 per hundredweight reduction in the price of Class I milk. Because in most months, the changes in the Class III price determine the change in the Class I price. Likewise, it is expected that price of Class II milk will be reduced by $0.17. That is because the Class II price is directly linked to the Class IV price.

As a family dairy farmer from southeast Michigan, I presently don't have a way to pass on these added costs that keep getting dumped on me. In the future if my family is to remain in the dairy business, we will have to have a tool or a way to deal with these added costs. That is why I am here today, to tell you that I support the changes proposed by National Milk. I believe that National Milk is correct in its assessment that Class I and II prices are a segment of the market where we as dairy farmers have the opportunity to recoup some of our increased operating costs, just like the processing industry does.

These are additional costs associated with producing milk for the Class I and II market. There are additional costs associated with producing milk for the Class I and II market. They include the cost of the financial investment required to comply with

Grade A regulations, the cost of milk assembly and hauling to more distant markets, and balancing the volatile seasonal and daily needs of a large processor. These costs were taken into consideration when the current Class I and II differentials were established by the USDA in 2000. All of these marketing costs have increased since 2000. My question for those who will decide the outcome of this hearing is this. If we can change the Class III and IV make allowances because costs have increased, why can't the Class I and II milk price formulas be changed to reflect the increased costs to dairy farmers.

The changes proposed by National Milk are desperately needed and require immediate and expedited action by the USDA. As I mentioned earlier in my statement, the change in the make allowances are expected to take effect in the very near future. It will place an unwarranted economic hardship upon me and other dairy farmers. Our increased costs of producing milk for the Class I and II market must be recognized.

T. Hood - Cross

Thank you for this opportunity to appear here today and for listening to my thoughts about a matter very dear to myself, my family and fellow dairy farmers.

JUDGE PALMER: We will receive Exhibit 19. Are there questions? Yes, sir. Mr. Lamers.

(Exhibit No. 19 was received into evidence.)

CROSS-EXAMINATION

BY MR. LAMERS:

Q. my name is Richard Lamers. Tim, you mentioned that Michigan milk operates two plants; is that correct?
A. Right.
Q. Do they manufacture dairy products?
A. Butter, we have dry butter and powder, some creams.
Q. And some creams?
A. Yes.
Q. Would not increasing the price of those products help the dairy farmers?
A. Increasing the prices that they can

T. Hood - Cross

sell those for?

Q. Yes.

A. It would help the profitability of the coop.

Q. But these products of creating the floor for all product prices under the Federal orders. Is that not correct? You have the base prices. These are three or four?

A. Right.

Q. Higher or whichever. So by increasing the price of those products would also increase the price of all other products, including Class II, Class I, which would return more money to the producers. Is that not correct?

JUDGE PALMER: The witness looks puzzled, and I'm not going to have him guess. You don't know, I gather.

A. In a way you are correct, yes. You are correct in a way. What my point is that lowering the Class III and IV make allowances -- or raising those make allowances has lowered our income and we have no way of passing that on.

T. Hood - Cross

Q. As a farmer?
A. And that lowers the Class I and II price that we receive.
Q. That is correct. But on the other hand, it's price of Class III and IV products that would be increased?
A. In the marketplace.
Q. In the marketplace.
A. Yes.
Q. And I realize that Michigan producers can't do that alone, but if that was done by the cooperatives in the marketplace, the farmers could recover the sustained losses you're expecting now?
A. I don't know if cooperatives have the right to increase the price of those.
Q. They sell the product?
A. They sell the product, but the market has to go up.
Q. Right. And cooperatives do have the power to influence the market by buying cheese at the cheese exchange at higher prices; isn't that correct?
A. Of the cooperatives of buying

cheeses?

Q. Yes. Cooperatives do buy cheeses now and then as well.

A. Our cooperatives don't.

Q. I know your's don't.

A. So I don't know about that.

JUDGE PALMER: I don't think he has to answer things that he doesn't have experience with.

MR. LAMERS: Thank you very much.

JUDGE PALMER: Any other questions? You're excused, sir. Thank you.

MR. HARNER: Paul Rovey from United Dairymen of Arizona.

PAUL ROVEY

a witness herein, having been first duly sworn, was examined and testified as follows:

DIRECT TESTIMONY

MR. HARNER: Your name is?

MR. ROVEY: Paul Rovey.

MR. HARNER: And this has been marked as Exhibit 20 and please read it into the record.

(Exhibit No. 20 was marked for identification.)

MR. ROVEY: Do I need to give my address too?

JUDGE PALMER: Tell us a little bit about you.

MR. ROVEY: My name is Paul Rovey. My address is 7711 West Northern Avenue in Glendale, Arizona, and I'm a dairy farmer from Glendale, Arizona. My family has milked cows and farmed in Arizona since 1912. I am a member of the United Dairymen of Arizona, the only dairy cooperative based in Arizona. I serve as vice president of UDA, and have been a member of the board for over twenty years. Our member dairies generate roughly 75 percent of the milk produced in our state. The herd size of our members is approximately 1,500 head. We regularly rank among the top one, two or three in the United States for milk production per cow.

I speak to you today as an individual dairy farmer, and as a representative of UDA. Anyone with any familiarity with the dairy industry knows that milk prices are cyclical. The most recent valleys of milk prices, however, have been particularly deep and extended. The combination of increased feed prices, milk prices that are still below average and higher fuel costs have taken their toll. Membership in UDA dropped by 26 percent over the last four years. Arizona's urban growth has forced many UDA members to move to outlying areas, further increasing transportation costs. That translates to even less money going to our producers.

Each month at our board meetings, we review the utilization of milk in our Order. We have been concerned about the increase in the make allowance of Class III and IV. We believe the industry will be better served by looking at the pricing system as a whole. Although the increase in the make allowance for Class III and IV was not as high as we had feared, it still made sense to us for the entire pricing system to be reviewed comprehensively. This hearing provides that opportunity, and we appreciate the speed with which the hearing was scheduled.

The proposals developed by the National Milk Producers Federation represent the input and interests of producers across the United States. As an individual producer, it just seems logical that if a make allowance increase occurs for Class III and IV, then its impacts on Class I and II should be taken into account. The NMPF proposal does two fundamental things: It increases both Class I and Class II prices and simplifies three calculations for determining the Class I milk price and the Class II skim milk price. The impacts of these changes results in a figure slightly over what the current make allowance change to Class III and IV takes away. That seems equitable, given the ongoing challenges to dairy farmers.

I might add that in working on the Producer-Handler issue, we found USDA to be attentive to the issue of equity and fairness. It also moved forward quickly once the hearings were completed. We appreciate both and are hopeful that the Department will act once again on principles of fairness and responsiveness.

As an individual producer, and as a representative of the United Dairymen of Arizona, I urge the Department's acceptance of the NMPF proposal. And I do appreciate this opportunity to present here today.

MR. HARNER: Please accept it into the record.

JUDGE PALMER: I receive his statement marked as Exhibit 20.

Are there questions? There doesn't appear to be any, sir. Thank you.

(Exhibit No. 20 was received into evidence.)

MR. HARNER: Steve Matthees.

STEVE MATTHEES

a witness herein, having been first duly sworn, was examined and testified as follows:

JUDGE PALMER: We have marked his statement as Exhibit 21.

(Exhibit No. 21 was marked for

identification.)

DIRECT TESTIMONY

MR. MATTHEES: My name is Steve Matthees. My address is 23216 West County No. 9 Boulevard, Goodhue, Minnesota 55027. Goodhue is located in Southeast Minnesota about 70 miles from the Twin Cities area.

I operate a family dairy with my son, my son-in-law and my brother. We farm about 760 acres of land and milk about 200 cows. My family and I are active participants in the dairy industry both off and on our farm; Amie, my oldest daughter, is the past Chairperson of the Goodhue County American Diary Association, ADA. And Nicole, my youngest, was a finalist this year in the state's Dairy Princess contest. This made for a very busy and exciting year for her and our family.

I am a member-owner of Dairy Farmers of America, DFA, and our farm markets all of our milk through the cooperative. I serve as a corporate director for Dairy Farmers of America, and our farm is located in DFA's Central Area Council which spans portions of Orders 30 and 32. Our Corporate Board of Directors, of which I am a member, has discussed and reviewed the proposal made by National Milk Producers Federation and supports its intent. DFA is a member of the National Milk Producers Federation.

I am not a technical expert on the inner working of the Federal Orders, and I am not prepared to answer many technical questions about them or this proposal. DFA member milk from our area is marketed to plants that make many types of dairy products. DFA manufactures cheese, butterfat items and dry dairy blends in plants that we own or are partners with others in the Upper Midwest. All of these plants are experiencing the same margin pressures that have been outlined in the recent make allowance hearings. I know this to be true because as a director of the cooperative, I review plant operating statements every month with management. Those statements reveal the difficulty our plants are having with dealing with higher costs. This is why the USDA recognized the problem and dealt with it in a reasonable manner consistent with the Hearing data. I understand from comments I've read in our agriculture newspapers and from my contacts with other dairy farmers nationally that some are concerned that the make allowance changes were not enough and others felt that they were too much. It would seem to me that the Secretary has picked a middle of the road decision in addressing the problem with the announced make allowance change that he has made.

If the proposal before you today is not accepted, it seems that the producers in my area that ship only or mostly to fluid processors will have their prices lowered unfairly as the make allowance changes will reduce not only the Class III and Class IV prices, but also the Class I and Class II. Since all prices are shared through the Orders pooling process everyone's blend price is affected. For those producers that ship most of their milk to the manufacturing facility that they own, they will have a chance to recover their income loss due to a lower blend price from the plant's profits that are shared back to the farmer. If this proposal is accepted, then all producers will have a chance to get their increased cost recognized, just like the manufacturing plants.

As I understand it, the main reason that this make allowance changes were necessary, is that the product formulas prevents a manufacturer from recovering his costs by raising prices. Any price increase in the marketplace gets reflected right back to the formulas, and there is no way for the manufacturers to be made whole. Our accountants and plant operators have made this fact pretty clear at our board meetings.

But these reasons do not seem to be true for Class I and Class II businesses in the industry. While it may not be easy for fluid processors to pass through the price increases, it is possible. And for those products, the increase do not get reflected in the price formula.

The changes proposed today would positively affect the prices for all dairy farmers in an Order. The increased prices would be part of the blend price and shared by every producer in the Order.

As a dairy farmer, I face many of the same cost pressures as a manufacturer. I pay electricity, diesel fuel, LP gas and gas. I hire labor. I pay for transportation, and I have other cost factors. I have summarized some of these costs on Schedule A at the end of this report. This proposal seems to recognize that I have cost pressures also and attempts to reflect them in the minimum order prices, something I think the Orders are supposed to do.

I can tell you our board had a lively discussion about why we should support increasing make allowances, and there were some who felt the coop should vote against the amendments and thus eliminate the Orders. This discussion reviewed the fact that we own and operate manufacturing assets, which we benefit from the change and the fact that we sell a lot of milk to other parties and would get less for those sales. However, as the discussion continued, we recognized that the Orders have a value to our members. And perhaps the most important, we realized that this hearing is the next step in the process of reviewing price formulas. We had hoped that these two steps would have been combined in the hearing in January but that did not happen.

The producers that I represent are pleased to see the Secretary is considering the fact that the producers do need a mechanism under the Order to reflect their production cost of increases also.

In our region this proposal will have a positive affect on the blend prices for Federal Order No. 30 and Federal Order No. 32. The industry is expecting the make allowances to be in effect in February. It would be very good if this proposal could be made effective at the same time. If that is not possible, then as soon as possible.

Your Honor, members of the USDA, I

S. Matthees - Cross

thank you for listening to my concerns, and I will try to answer any questions that I can.

MR. HARNER: Please accept Exhibit 21 into the record.

JUDGE PALMER: Yes, received. Any questions? Yes, sir. Mr. Yale.

(Exhibit No. 21 was received into evidence.)

CROSS-EXAMINATION

BY MR. YALE:

Q. Good afternoon. It's your understanding -- first of all, you are aware, I think you've hinted at it, maybe didn't directly say it in your testimony, on III and IV that did bring in a reduction in the blend prices because it in effect reduces all four prices; right?

A. Yes.

Q. And your expectation is that with the proposal as noticed, with those numbers, the plus $0.77 for Class I, that on a blend price basis all of that reduction from the make allowances will be made up in the higher Class

S. Matthees - Cross

I price, plus some; right? Is that your understanding?

A. Of the make allowance?

Q. Your understanding is there is a proposal, I think you talked about this, they voted on the Order, that if nothing else happens, the overall blend price in Order 33 will go down based on what their utilization is, but they will go down maybe 25, $0.30; right?

A. Right.

Q. And your expectation is that this Class I hearing that we're hoping today will increase the portion of that blend price enough that it will offset all of the reductions on all four classes that we're facing and possibly actually increase the value of the blend. Is that your understanding?

A. That's right.

Q. So are you also aware that although this rule on the make allowances, if the producer's approval will come into effect, that's not the last opportunity for the Secretary to adjust those make allowances. Do

S. Matthees - Cross

you understand that?

A. I guess that I was not aware of that.

Q. Well, just for the moment let's say that it is, that they get another opportunity to review comments and make adjustments up or down in that make allowance. The question I come to though is that you don't want to be in a situation as a result of this testimony and then subsequent changes in the make allowances that what we do on the Class I is insufficient to cover all of the make allowance changes that ultimately come out of that proceeding.

MR. HARNER: If you don't understand the question --

Q. You are supporting this proposal because it in the end you believe it will raise the blend price in your Order?

A. Yes, that's correct.

Q. And that if there are subsequent changes in another proceeding that lower the blend prices even further, you want an offset to cover that as well; is that right?

A. I would suspect we would address

S. Matthees - Cross

those issues at that time.

Q. But that is part of the problem you mentioned earlier because they're separate, we have to deal with them separately rather than together. But your overall goal is to improve the blend price for your producers?

A. I am hoping to recover my increased cost of production that I have in my area.

Q. Which means that you need more than you are getting now?

A. That's correct.

JUDGE PALMER: You have a question, Mr. Dibbell?

MR. DIBBELL: Yes, I do.

CROSS-EXAMINATION

BY MR. DIBBELL:

Q. You're a PFA member and I believe you said director?

A. Yes.

Q. And you've reviewed the plant operating costs, and you are trying to justify their getting an increase out of your pocket. Have you reviewed your operating costs on the

S. Matthees - Cross

farm, and how does it compare to the plant operation? Are they worse off than you as a dairy farmer?

JUDGE PALMER: Do you care to answer that?

MR. MATTHEES: I care not to answer that.

JUDGE PALMER: He doesn't understand that question. It's a little complicated for him.

Q. It's not all that complicated. Does your bottom line reflect low prices as well as their high operating cost reflects bottom line figures? You reviewed the plant operation, but it sounds like you haven't reviewed your own farm operation financial statistics.

A. I care not to answer that. He can't judge how I view my operations.

JUDGE PALMER: Okay. We're where we are on that. Thank you, sir.

MR. HARNER: Ricky Williams.

RICKY WILLIAMS

a witness herein, having been first duly sworn, was examined and testified as follows:

MR. HARNER: State your name.

MR. WILLIAMS: Ricky Williams.

MR. HARNER: Have you prepared some testimony to present today?

MR. WILLIAMS: Yes, I have.

MR. HARNER: Please mark it as Exhibit 22 and please read your testimony.

(Exhibit No. 22 was marked for identification.)

DIRECT TESTIMONY

MR. WILLIAMS: My name is Ricky Williams. My address is 4019 Red Oak Road, Baxley, Georgia, 31513. Baxley is in Southeast Georgia about 220 miles south from Atlanta.

I operate a family dairy with my father. We milk 600 cows and grow all our own feed. My family also operates a milk hauling business that delivers milk from farms in George and Florida and delivers to plants in

Florida and South Carolina and Georgia. Our business also transports supplemental milk into the Southeast from the Midwest during several months out of the year.

I am a member-owner of Dairy Farmers of America, and our farm markets all of our milk through the cooperative. I serve as a delegate for DFA. Our farm is located in DFA's Southeast Area Council, which spans portions of Orders 5, 6, 7, 32 and 126. Our Council Board of Directors has reviewed proposals made by National Milk Producers Federation and supports its intent. I have had discussion with both DFA staff members and my local director about the proposal. DFA is a member of National Milk Producers Federation.

I am not a technical expert in the inner workings of Federal Orders, and I am not prepared to answer many technical questions about them or this proposal. I do have a general understanding of the proposal being discussed here today and can tell you that it will have a positive affect on my farm, my neighbors in Georgia and the producers in the

Southeast.

Dairy farmers in the Southeastern United States need some significant modifications to pricing mechanisms in Federal Orders. In the Southeastern markets demand for fluid dairy products is growing steadily as population increases, but the milk supply and number of farms is decreasing. The Southeast lost the equivalent of a load of milk a day in the month of November from DFA deciding to go out of business. The natural consequences of make allowances being increased in the price formulas will lower Class I and Class II prices in the Southeast. This simply does not make sense in our market.

As a result of the make allowance hearings, we understand that prices for Class I and Class II milk will also decrease. Since our markets are very heavily fluid oriented, this means our prices will decrease, in the face of a declining supply and increasing demand.

While there are manufacturing plants in the Southeast, only a small portion of the milk produced in the Southeast is processed in them. They are mainly used for balancing and many of them run to capacity only a few days a year. So the opportunity to recover the reduction in income due to the increased make allowances through the plant returns are limited. The make allowance changes affect all farmers prices.

Price formulas that are only reflective of the cost factors that affect cheese, butter and powder manufacturers must be modified if they are going to be meaningful to the higher fluid use market conditions in the Southeast.

As I understand the proposals being presented here today, they will recognize that the costs to maintain and service fluid markets have increased since they were put into the Federal Order price formulas in 2000. In fact, my farm faces many, if not all, of the types of cost increases that were outlined in the make allowance hearings. I buy electricity and natural gas, hire labor and pay for transportation. A specific example of how costs have changed on my farm is the fuel cost necessary to operate the machinery to harvest the corn I grow. In July 2004 my records show that I paid $11,289 for fuel. In July of 2006 that cost was $22,833, more than double.

In our market as farms go out of business, the cost to assemble loads of milk for customers goes up. There are fewer farms and the distance traveled to assemble a load of milk increases. As plants get larger, a down day or just a less than seven-day receiving schedule makes them more costly to balance. Our alternatives are a longer haul because in the Southeast there are only a few balancing plants; or we must build plants with more capacity, which doesn't make much sense if you only run them a few days in the month; or pay someone else to maintain that capacity or pay plants in the reserve supply areas a fee to process milk there.

Just as energy costs increases need to be considered in a cheese plant or a drying plant, they need to be recognized for a dairy farmer. If Proposal I is not adopted, dairy farmers in the Southeast will not have a chance to recover these increased costs.

Thank you for listening to my concerns, and I will try to answer any questions that I can.

MR. HARNER: Please accept this into the record.

JUDGE PALMER: We will receive 22, and I'm going to say 21. I believe I did receive it, but I just want to make sure.

Questions? There doesn't appear to be any. Thank you.

(Exhibit Nos. 21 and 22 were received into evidence.)

JUDGE PALMER: Let's call the gentleman in the back, Max Smith.

MAX SMITH

a witness herein, having been first duly sworn, was examined and testified as follows:

JUDGE PALMER: Sir, let me help you out here. Give your full name.

MR. SMITH: My name is Max D. Smith.

JUDGE PALMER: You have a statement which I'm going to mark as Exhibit 23, and now give where you live and you have it on your statement.

(Exhibit No. 23 was marked for identification.)

DIRECT TESTIMONY

MR. SMITH: I live at RD 2, Box 32B, Martinsburg, Pennsylvania.

JUDGE PALMER: Go on with your statement.

MR. SMITH: I am not an attorney. I am not a coop employee. I am not a coop director. We do market our milk to Maryland and Virginia produced coop.

I'm speaking today to represent our family farm as well as our many neighbors who could not be here today. We are a fifth generation family farm located in South Central Pennsylvania. Our ancestors have milked cows since the early 1900's. Profitability has always been a standard procedure on our farm. Since the year 2000, it has become harder and harder to turn a profit. Except for a short time in late 2003 and 2004, break even or a net loss has been more commonplace.

We milk more cows, produce more milk and work longer hours to receive the same price we were paid in the late seventies. We have 400 cows and usually milk 350 to 360 on a daily basis considering dry cows. We ship approximately 8.5 million pounds on an annual basis. Our milk components average 3.8 butterfat and 3.15 protein most months. In 2005, our net farm price averaged 15.73 per hundredweight. In 2006, our average net farm price will be close to 13.40 per hundredweight. Both years' prices include a $0.30 per hundredweight quality premium. Quick calculations tell us that our milk income is 2.33 per hundredweight less or $198,50 for 2006.

Seeing the expenses, actual true expenses have been lacking at this hearing so far so I have some. Expenses in 2006 compared to 2005. Fuel was up 25 percent, labor is up 15 percent, our insurance is up 8 percent, primarily due to workmen's comp, our bedding costs, primarily sand and sawdust, are up 40 percent. That is due to taking the sand out of the ground and getting it hauled in by trucking and fuel costs, and sawdust is almost impossible to find because it's being used for pellet mills or for pellet and wood stoves and so forth. Our taxes are up 9 percent because both the county and school district had negative budgets and raised the real estate taxes. When you total these increases, they equal another $1.10 per hundredweight or $93,500 so far. So in 2006 we have had the decrease in milk prices and increase in expenses which totals $291,550 less to work with than in 2005. My question to USDA is where do we make up this difference. Would you call this our make allowance.

Now let's look at feed costs. In the last three months corn has gone from 2.60 per bushel to over $4.00. Soybean meal, as well as other protein sources, have increased also. Last week we worked with our accountant and did some number crunching and arrived at the fact that if grain prices stay where they are currently, the increase in feed cost to produce milk is $0.63 per hundredweight over August 2006 costs. This will have a major impact on producer costs in 2007.

The Northeast dairy benchmark summary of 2005 which was referred to several times per day lists the total expenses per hundredweight of the top 10 percent producers in the Northeast at $17.47 per hundredweight. Our 2006 average price of $13.40 per hundredweight is more than $4.00 hundredweight under this. How do we replace equipment and facilities with this scenario? We have dairy farm neighbors who have no debt who are borrowing money just to pay their bills. Dairy farmers in the Northeast are at a crossroads.

Shall we as dairy farmers plan for 2007 and beyond, or should we turn the Northeast into a massive housing development? What USDA decides in the next few weeks will tell us if agriculture is going in the same direction as textiles and manufactured goods in this country.

M. Smith - Cross

In conclusion, I plead with you to reserve the family dairy farm and approve the $0.77 per hundredweight increase in Class I and look at some type of emergency pricing to cover the increase in feed costs. We ask that you would provide a fair price for our product and take the high road and rule in favor of the producer.

Thank you for your time. Sincerely, Max D. Smith.

JUDGE PALMER: Mr. Smith, first of, all we will receive your statement in evidence as Exhibit 23.

Are there questions for Mr. Smith? He had a good bit of information. I'm wondering if anybody wants to go into any of the data that he put forward. Yes, sir.

(Exhibit No. 23 was received into evidence.)

CROSS-EXAMINATION

BY MR. CROSSLAND:

Q. Edward Crossland for Lanco-Pennland Producers.

M. Smith - Cross

Mr. Smith, from your testimony I understand that you market 8.5 million pounds of milk; is that correct?

A. That's correct.

Q. You were present here yesterday when the economist from National Milk Producers indicated that for Order 1 -- and you are an Order 1; correct?

A. Correct.

Q. That Order 1 received an increase of about $0.35, and that's without any differentials or anything else taken into account. I calculate that out to be an increase in your income of $12,750. Will $12,750 offset your increase in costs for this year?

A. No.

Q. Will you continue or will you be able to be profitable in the future with just that increase?

A. No.

Q. Is your farm in jeopardy if you do not get an additional increase to offset this?

A. I would say we're just like merely

M. Smith - Cross

every other size farm in our area that has expanded and incurred debt.

Q. Have you been able to determine approximately how much of an increase in milk you need to be able to cover your costs?

A. Increase in milk price?

Q. Yes, per hundredweight.

A. Four dollars would get us pretty much close to where we would have some money to replace facilities and equipment.

MR. CROSSLAND: I have nothing further, Your Honor.

JUDGE PALMER: I presume you attend some of these meetings that you coop. I presume that you and other farmers must say we need another $4.00 per hundredweight to make it. What kind of response do you get? What happens? Do you bring that up?

MR. SMITH: Well, there is some that need a lot more than that, but it's all we talk about. I mean, you go to bed at night and that's what you think about is we're $298,000 less income than we had last year.

JUDGE PALMER: What you are

saying is so direr. I don't know enough about the workings in the milk industry. I know a little bit from hearings but not the real nitty-gritty. I'm wondering if you're losing money, why are you selling milk? What is your bargaining situation with these folks.

MR. SMITH: We are just like any other producer to a coop. You sell your milk or you go out of business.

JUDGE PALMER: But as I say, when you go to the meetings -- because you are a coop member?

MR. SMITH: Correct.

JUDGE PALMER: You must say we need more money for our milk. Why don't you raise the prices so we can get more money to us. What happens?

MR. SMITH: They tell us we need to talk to these people.

JUDGE PALMER: So you are talking to them.

MR. SMITH: Yes. That's why I am here today.

JUDGE PALMER: Any other

questions? All right, sir. You are excused. Thank you very much.

Let's go off the record for the moment and see where we are.

(Discussion held off the record.)

JUDGE PALMER: Back on the record.

THOMAS PITTMAN

a witness herein, having been first duly sworn, was examined and testified as follows:

MR. HARNER: Please state your name.

MR. PITTMAN: Thomas Pittman, P-I-T-T-M-A-N.

MR. HARNER: Have you prepared any testimony for today?

MR. PITTMAN: Yes; I prepared some testimony on behalf of Southeast Milk.

MR. HARNER: Could that please be marked as Exhibit 24.

JUDGE PALMER: Yes, so marked.

(Exhibit No. 24 was marked for

identification.)

MR. HARNER: Please read your testimony.

DIRECT TESTIMONY

MR. PITTMAN: My name is Thomas Pittman. I'm employed by Southeast Milk Inc. as director of Milk Accounting & Economic Analysis. My office is located at 1950 Southeast Highway 484, Belleview, Florida, 34420.

Southeast Milk, Inc., SMI, a dairy cooperative with 321 dairy producers located in Florida, Georgia, Alabama, South Carolina, Louisiana and Tennessee market, and we have over 2.85 billion pounds of milk annually in the Florida and the Milk Marketing Orders.

SMI supports the proposals one through five as submitted by National Milk Producers Federation. USDA has updated make allowances for Class III and IV, and we support the request from National Milk with that Class I and II prices be updated on a timely basis as well.

When the new make allowances for Class III and IV prices are implemented and used in the price formulas, producers who supply the fluid market will incur a reduction of income. Why? Because the relationship between the Class I and II prices and Class III and IV prices and the lowering of the Class III and IV prices through the make allowance adjustment.

Producers who supply the fluid market, especially in the milk deficit areas, are incurring higher costs just to supply the market. These increased costs come from balancing the market, transporting the milk to the plant, and energy costs to produce the Grade A milk. These costs have all increased greatly over the last 24 months.

The cost to balance markets have increased due to higher transportation costs and lower returns on milk going into balancing plants. Fuel costs have increased greatly over the last one and a half years. When surplus milk needs to be moved out of the region to the nearest balancing plant, the cost to move that milk has increased at times up to 40 percent because of the cost of fuel. Balancing plants with their increased manufacturing costs to process the milk having offered lower prices for the surplus milk. This lowers the returns to producers who balance the fluid milk markets.

Most milk processing plants are located in large urban areas. Because of the growth of the urban areas into the rural areas, especially in Florida and Georgia, procurement areas for these plants have grown as well. Trucks that assemble milk are running more miles than ever. The higher costs to cover these miles have come from the producers. These costs need to come from the market.

Almost all of our fluid processing customers have higher standards for receiving raw milk than what is currently legal from the Pasteurized Milk Ordinance. We do not receive any additional compensation from the processor for the higher milk quality levels that are greater than the PMO, even though there is extra associated in providing that milk. The producers who supply the fluid market bear these additional costs, even though the milk is Grade A.

We request that the Department move quickly on an emergency basis with this testimony from the hearing. Since the beginning of the year, SMI saw almost an 8 percent decrease of their farms quit producing milk this year. Producers need relief now from bearing all of these extra costs in supplying the fluid market.

This concludes my statement.

MR. HARNER: I have a few questions, but, first, I would like to offer Mr. Pittman as an expert and ask that Exhibit 24 be accepted into the record.

JUDGE PALMER: Does anybody wish to voir dire Mr. Pittman? Does anybody have a problem with accepting him as an expert? There doesn't appear to be any. We'll so accept and we'll receive his statement as 24.

(Exhibit No. 24 was received into evidence.)

T. Pittman - Cross

CROSS-EXAMINATION

BY MR. HARNER:

Q. Please describe your previous work experience containing the Class II fat.

A. Prior to joining Southeast Milk a year and a half ago, I spent the previous 12 years before that working for two of the four largest ice cream companies in the nation, mainly procuring dairy ingredients for them, designing risk management programs for them.

Q. What conclusions do you draw regarding the substitutability of anhydrous milk fat for fresh cream in Class II products?

A. It would be very limited in the scope for these plants to make these changes. To handle anhydrous milk fat is a very manual intensive labor situation where the employees would have to handle blocks of this and then to have the equipment to process it. Currently these plants receive the fresh cream basically up close and up tight to turn on pumps and turn off pumps. Manually to handle that much fat is going to be very difficult. And the other aspect was in looking at the quality of the

T. Pittman - Cross

finished product coming off. We will suffer some really deteriorating taste of ice cream products that are used to anhydrous milk fat.

MR. HARNER: No further questions at this time.

JUDGE PALMER: How did we get into anhydrous milk fat? I'm a little lost here.

MR. HARNER: He has experience in the area and it affects part of the proposal.

JUDGE PALMER: Good enough. Fine. Questions? Yes, sir.

CROSS-EXAMINATION

BY MR. ROSENBAUM:

Q. Steven Rosenbaum for International Dairy Foods Association.

I take it you do receive over-order premiums?

A. Yes.

Q. And those are from these processors who were requiring this higher milk quality levels; is that right?

T. Pittman - Cross

A. Yes.

Q. Is the amount of the over-order premium tracked to particular services?

A. The model of the over-order premium are lumped together for balancing the market, trying to get into some of these, you know, as far as receiving milk every day or not every day, receiving the same volume of milk.

Q. What is the current over-order premium?

A. In the Florida market it is a net three dollars and I think about 25 cents in that area.

Q. Is that made up of specific identifiable components?

A. It's not specific components, no.

MR. ROSENBAUM: That's all I have.

JUDGE PALMER: Other questions?

CROSS-EXAMINATION

BY MR. TOSI:

Q. Good afternoon, Mr. Pittman. Thank

T. Pittman - Cross

you for appearing today.

There are times in the year where you have to divert milk away from bottling plants to manufacturing plants?

A. In our market we have about six months of the year where we have surplus milk where we have to, yes, divert milk from our bottling plant or it's too much milk to go to the manufacturing plants or balancing plants.

Q. Are you the handler that has the name and obligation to the accounting pool at the, for example, the Class III or Class IV prices?

A. Yes.

Q. When you divert that milk to a more distant manufacturing plant, do you receive the minimum price, or do you receive something more or less for that milk?

A. On average for most of the milk that we send out to or divert to other processing plants we receive usually less than the Federal Order price for that milk.

Q. Would you care to offer typically how much less?

T. Pittman - Cross

A. It will vary from some at times to be about $0.25 per hundredweight, others at times to $3.00 per hundredweight under, depending on the time of the year and the amount of surplus milk that is available, like at holidays.

MR. TOSI: Thank you very much.

JUDGE PALMER: Other questions? Mr. Vetne.

CROSS-EXAMINATION

BY MR. VETNE:

Q. Good afternoon, Mr. Pittman. John Vetne.

In response to the question by Mr. Rosenbaum, he said that the premium of $3.25 quarter on Class I milk does not have identifiable components. Let me carry that over a little further. Is the uniform receiving credits that are subjected from that announced premium?

A. Yes.

Q. Are there competitive credits that

T. Pittman - Cross

are subtracted from the announced premium?

A. Yes.

Q. What other items, lined items that might be subtracted from the announced premium?

A. Producer rates, producer butterfat tests that the buyer would buy weights that are picked up from the farm and tests that are determined from the farm multitest. Those are stuff that are more common credits that are given.

Q. Let's go back to the uniform receiving credit. When a handler agrees to receive milk in a farm for seven days a week, that results in reduced balancing costs for the supplier and essentially shifts those balancing costs to the receiver who wants to have the pleasure of capacity at his hands?

A. That is correct.

Q. With respect to the premiums, is that a Class I accounts price, is that a price that is charged only by SMI, or is it a price charged jointly by SMI and other suppliers according to the market?

A. It is a price determined through the

T. Pittman - Cross

agency of several cooperative of the supplier market.

Q. Does the agency have a name?

A. SDCA, Southern Dairyman Cooperative Association.

Q. Does that agency coordinate milk supplies in markets other than Florida?

A. No, just Florida, strictly Florida.

Q. With respect to the proceeds of the Class I premium, are those proceeds allocated to the members of the SDCA based on the services and costs to each participant it incurs?

A. Currently the arrangement is that each cooperative keeps their own money that they collect from the plants. So if one plant has a higher balancing cost, one cooperative has a higher balancing cost with a plant, that that cooperative won't incur that cost by himself.

Q. Now, does SMI incur a seasonal cost to import milk from northern production areas?

A. Yes. We import milk five, six months a year, and we have to pay the extra to

T. Pittman - Cross

get that milk, especially in the last couple of years with the transportation conflict in Ohio. It's really put an extra burden on producers.

Q. There is a report published weekly by dairy programs, dairy market, showing shipments from Wisconsin to Florida. Are shipments arranged by SMI among those shipments reported by USDA?

A. If it's shipments specifically from Wisconsin, no, because we don't purchase any of our import milk from Wisconsin. It's purchased from other areas in the country outside of Wisconsin, but there would be numbers reported in there. So it would be included in there.

Q. What supply regions do you normally reach to during the fall, late summer and fall months to get a supply?

A. We will reach into West Texas, New Mexico, Michigan, Indiana, Pennsylvania, our primary regions.

Q. Would it be correct to say that some of the revenue realized from the $3.25 premium is used to offset those additional costs for supplemental bills?

T. Pittman - Cross

A. Yes. As we go through the course of the year, quite a bit of that revenue goes to cover that, because you have to pay a fuel cost for getting that milk between plants and then also have to pay the transportation to get it down there. So it gets to be quite costly there.

Q. In the spring months when the milk that's supplied in Florida produces more milk required than from fluid needs, it is the revenue from Class I premiums applied to offset the costs of hauling surplus ability to distant manufacturing plants and accepting in some cases less than class prices?

A. Yes.

Q. You made some reference to the loss of producers. Were those SMI members?

A. Correct.

Q. And that was what percentage?

A. Eight percent since the beginning of the year.

Q. What about volume? Have you had milk volume loss since the beginning of the year?

T. Pittman - Cross

A. Our volume loss within the Central Florida area that's been mainly the producers we have left. I believe it's down to about 5 percent, 5, 6 percent in that area.

Q. So some of the cows from the producers that left the business went to other farms to increase their size?

A. Some of the cows went to other farms, other cows went to out of state areas. We also did increase pickup to a few members outside from the State of Florida from other cooperatives.

Q. With respect to the SMI supply that is marketed to the Southeast market, is there a similar Class I premium structure for that region?

A. It gets lower. The farther you get away from Florida the Class I premium does get low.

Q. What is the current prevailing premium for Southeast market?

A. It's $2, $2.35.

Q. With respect to the Southeast premiums, are there similar credits for farms

T. Pittman - Cross

receiving other things?

A. Yes.

Q. With respect to the Southeast Class I premiums are the revenues used similarly to offset the costs for supporting supplemental milk and hauling out surplus milk?

A. Yes. If we look at all of the states in the Southeast basically from Louisiana to the Atlantic Ocean, and from Tennessee, South Carolina, all of those states operate at a deficit really except for Florida, and Florida has some surplus in the spring time of the year. When you get states like Alabama, even Georgia now is where we have to import 12 months of the year just to supply and make a profit.

Q. At some point during 12 months of the year there are weeks or periods within those months in which you must export, for example, holidays?

A. Correct, over the holidays, Christmas and New Years, especially.

Q. In the $2.00 range, 2 to $3.00 range Class I premium for the Southeast market

T. Pittman - Cross

proceeds that are used similarly to offset those costs for which in that market primarily securing supplemental milk?

A. Yes.

Q. With respect to that market, are those costs pooled among participants in the over-order premium structure?

A. Yes.

Q. So in that market if one participant incur greater costs than others, then that participant will receive a proportionately greater share of the premium proceeds?

A. Say that again.

Q. If one participant incurs disproportionate, say, supplemental milk importing costs, that participant doesn't bear alone everybody's premium dollars that goes to reimburse that participant?

A. Right.

MR. VETNE: Thank you.

JUDGE PALMER: More questions? Yes, Mr. Tosi.

T. Pittman - Cross

CROSS-EXAMINATION

BY MR. TOSI:

Q. Good afternoon, Mr. Pittman. I neglected to ask this question before. On the milk that you divert to manufacturing, who pays the cost of that haul?

A. Producers in the Southeast, SMI.

Q. Do you have to receive a -- do you often times receive a price less than the over-order of minimum class price and transportation?

A. Yes.

Q. In that regard, does that figure into the level of the over-order premium structure that you have?

A. We keep track of that cost on an annual basis. We see what comes off per hundredweight, and, yes, that is looked at and made sure we get enough of premium next year. It's a separate line item to say the premium comes to that, but we make sure that cost is covered when that premium is charged.

Q. To the extent that you view the level of the Class I price, whether you look at

T. Pittman - Cross

it in terms of the level of differential or the Class I price Order, to the extent that you see it as being insufficient, what is it about your market that would limit you to being able to recover some of that cost through your ability to negotiate with the Handler, in other words, to get it out of the marketplace?

A. Some of the factors prior or are really what's going on is what potential companies could supply that milk into that market. Prior to this year, there was no big cheese plant in Texas, New Mexico. Now that it is operating it's taken that supply of milk off the market and it's filling up that cheese plant, but prior to this year, that milk was available it was being shipped all over the country in different areas, and those producers actually were receiving a price that I'm surprised they are able to stay in business, but that was a short-term cost for a long-term benefit of having a plant there, but we had outside pressures on that point, but with where the fuel prices went in the last 12 to 14 months it's kind of slowed down that pressure

T. Pittman - Cross

for us, realizing that if you've got 6 to 7, $8 per hundredweight haul of milk, that's quite a cost to haul, and so it's kind of slowed those movements somewhat. So have we attempted to push premiums higher, I think part of it is waiting to see what comes out of everything here with make allowance adjustments with III and IV and see what happens with this one, if there is -- if we are not going to get satisfactory help through the Department, we may have to take matters into our hands and do things that we have to do to consult these firms.

MR. TOSI: Thank you, Mr. Pittman.

JUDGE PALMER: Questions? Mr. Yale.

CROSS-EXAMINATION

BY MR. YALE:

Q. Good afternoon. I kind of want to follow up on this issue of these diversions and how those fit into the scheme. Do you have any contracts for reserve supply with anybody?

T. Pittman - Cross

A. We have several contracts. We have actually four different contracts for reserve supplies.

Q. How does a reserve supply contract works?

A. One of two ways; one way is to pay an extra premium at the time you purchase the milk, give up charge. It can vary some times up to $1 per hundredweight or better. Another method of what we use is we will pay a flat fee on a year-round basis. It can vary from supply to supply what that fee will be, how we need the milk and how we balance the salt is what that fee will be based on negotiations we get from there, but those are the two methods that we use to reserve supply.

Q. Now, when you talk about diversions, are you talking about any of the milk that is available under the reserve supply contract?

A. What do you mean by diversion?

Q. You were talking about you have to divert surplus milk out of the state?

A. Yes.

Q. Does that include any of the milk

T. Pittman - Cross

that is under your reserve supply contract?

A. No.

Q. That's in addition to that?

A. Yes.

Q. So under your reserve supply contact you are already balancing some of your market because that supply is there when you need it. You don't have to buy it if you don't need it; right?

A. Right.

Q. Now, you mentioned there are six months out of the year I think was your testimony that you have a surplus supply?

A. Yes.

Q. Now, is that a daily surplus, or is that a weekend or holiday in some of those months, or is it again or is it a continuous surplus?

A. Basically, as the milk productions shifts from, say, from shortage to surplus we will have one or two weeks where there would be a full balance, and then as we move into that period where we're going to have more surplus, it will tend to be more on weekends at first,

T. Pittman - Cross

and then as we get into strong surplus time it's seven days a week, but it tends to kind of be on weekends at first.

Q. Do you have a long-term contract with people to accept your surplus milk, or is that all sold on the spot basis?

A. Basically, it's set up on -- we got one situation where it's a supply basis, but then the other ones are on an annual basis, kind of sit down and renegotiate basis.

Q. I think you somewhat answered Mr. Tosi's question, but I want to get a little more bit clarified, and that is this issue of you get enough out of your over-order premiums to offset the cost of the diversions. Okay? Do you at the end of the year look at your total volume of milk and compare that to what it should have brought it as a class prices? Do you use that kind of test, or how do you determine whether or not you broke even or not for premium?

A. We look at each year. We take it on a month-by-month basis. We definitely lose, getting rid of milk or bringing in milk, but on

T. Pittman - Cross

an annual basis when we look at it, we do it on a price per hundredweight of what that cost is to export or to bring in milk and against our total estimated production. So we know what it is costing our producers on an annual basis, and that way it kind of gives us each an indication of our cost getting higher and higher, and what we are finding is that the actual import is going more and more because we're getting more short of milk and balancing the surplus is getting lower because the milk is actually declining.

Q. But at the end of the year do you stay pretty close to the minimum prices or perhaps your import cost or premiums exceed your import cost and surplus?

A. At the end of the year we will be slightly above the blend prices which is a slight premium of net paid to producers.

Q. Now, you understand this is an application just for -- the proposal as it stands right now is an increase of $0.77 in the Class I price?

A. Yes.

T. Pittman - Cross

Q. It's not the formula that you are worried about. You just want the more money; right?

A. We need the money.

Q. In fact, you had another proposal, I think, that you were supporting that would just have a separate formula for advance III and IV that wouldn't change the make allowances; is that correct?

A. The initial proposal that we put to the USDA when they requested a proposal was to not change the make allowance for the Class I and II prices.

Q. Now, in your opinion if the minimum class price goes up or Class I prices are proposed, are you going to be able to retain the same premium structure on top of that that you currently have?

A. We certainly hope we will. You don't know for sure until you get to that moment. I would say we will feel some pressure from the processors to say, well, okay, if you are going to get a $0.77 increase on the class price, there are going to be some of that reduced on the premium side.

Q. Put it this way. We would feel very fortunate if they didn't give us any opposition, but I'm confident that we will feel some opposition.

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

JUDGE PALMER: Any other questions? Mr. Cryan.

MR. CRYAN: I have a question. Tom, Mr. Harner asked you about anhydrous milk fat. With everything you said about anhydrous milk fat, limited substitutability and class products associated with it, would that also apply to butter and butter oil?

MR. PITTMAN: Yes; that would apply to butter and butter oil.

JUDGE PALMER: I think that is it, sir. Who next? Let's take a quick recess, like five minutes.

(Short recess taken.)

JUDGE PALMER: Back on the record. This is going to be 25.

(Exhibit No. 25 was marked for

identification.)

ELVIN HOLLON

a witness herein, having been first duly sworn, was examined and testified as follows:

MR. HARNER: Please state your name.

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

MR. HARNER: Please describe your background in education and experience.

DIRECT TESTIMONY

MR. HOLLON: I have a master's degree in Agriculture Economics from Louisiana State University and a bachelor of science in dairy manufacturing. I've worked for Dairy Farmers of America or its predecessors since 1979. I have been involved in dairy statistics and price forecasting. I have been involved in day-to-day buying and selling of raw milk in most markets east of the Rockies and not in the Northeast but close, and I deal with National Agricultural policy and work quite often with Federal Order hearing and activities. I've testified in a number of Federal Order hearings. A period of my job duties involved buying and selling milk on an everyday basis with A and PI's Customers in the Upper Midwest and in the Southwest, and I am here today to present the DFA's views on the National Milk proposal that Dr. Cryan outlined.

MR. HARNER: I would ask that Mr. Hollon be accepted as an expert.

JUDGE PALMER: That would be a question of whether or not there is any need for any voir dire. We'll reserve that.

MR. HARNER: And you prepared testimony here today.

MR. HOLLON: I have a six-page statement prepared.

MR. HARNER: Which has been marked as Exhibit 25. Please read it.

DIRECT TESTIMONY

MR. HOLLON: Statement of Dairy Farmers of America, Inc.

DFA is a member-owned Capper Volstead cooperative of 11,500 farms producing milk in 49 states. DFA pools milk on 9 of the 10 Federal Milk Marketing Orders. DFA is a supporter of Federal Milk Marketing Orders. Orders are an economically proven marketing tool for dairy farmers and we believe without them dairy farmers' economic livelihood would be worse.

The central issue of this hearing is to review and determine if the current product price formulas for Class I and II milk adequately reflect the cost of producing and marketing that milk to its intended use and if not, what might be a better formula. Failure to address this issue will be detrimental to the members of DFA both in their day-to-day dairy farm enterprises and in the milk processing investments that they have made. We appreciate the swift response that the Secretary has given to this issue. We have worked hard to compile data and evidence with the other members of National Milk Producers Federation to support the proposal and feel we have substantial information to put into the record. We think that the Dairy Division's new direction of more narrowly focused hearing topics will serve the industry well and will provide for a more clear hearing record.

DFA supports Proposals 1 through 5 as offered by National Milk and supports the testimony of Dr. Cryan as he outlined the need for the changes, the workings of the various price formulas and the results from the changes.

The dairy industry is under tremendous margin stress at the farm level. According to our records in 2006, DFA has seen 830 farms cease dairy operations nationwide through the first ten months of the year with 121 of them in October alone. At our most recent Corporate Board meeting there was keen interest from our directors in milk prices for next year, estimates of how milk production cost factors, how much the make allowance changes in California and Federal Order system would lower milk prices and the impact of this proposal on milk prices. They urged staff to work hard to explain how this proposal would be helpful to their operations.

In the Make Allowance Hearing of January 2006, DFA supported changes such as this proposal would establish as a part of a group of proposals. The combination included support of minimal and reasonable adjustments in the make allowances for Class III and Class IV price formulas and the inclusion of an energy index in those formulas. We also supported provisions that would ensure that Class I and Class II prices would not be lowered as a result of any changes in the manufacturing class price formulas. While we were disappointed that the Class I and II proposals were not allowed to be included in that hearing record, we are pleased that it is being heard now.

The make allowance changes that were justified in that hearing (Proposed Rule - Docket No. AO-14-A74, et al; DA 06-01) were reflective of the changing economic factors that affect the cost of manufacturing milk into dairy products. While many cost factors were outlined, the one with the most pronounced effect was energy costs. Perhaps the second most significant factor was that the formulas themselves had not been revised in many years and much of the data that supported them were several years old.

A key factor identified is the make allowance hearings is the problem with the use of the NASS prices in the formulas. Clearly the formula mechanics prevent a manufacturer of benchmark commodities from recovering cost increases by raising prices. Thus a change in make allowances is the only way, given the current price formula construction, that manufacturers can recover their increased costs. But Class I and Class II products are not so constrained. Those products are not part of the NASS survey and manufacturers are not limited in any way by the product price formulas from recovering any costs of production they may have through negotiations with buyers.

But under our current price formula mechanisms when Class III and IV prices are lowered, prices of Class I and II products are lowered at the same time. Because of the pooling provisions of Orders all farmers share in the lower returns.

Even though it is difficult to explain and accept, many, but not all, DFA members accepted the changes in make allowances as they affected Class III and IV operations because they realize they need to have viable manufacturing operations to provide a market for milk. In some cases they market their milk through a DFA owned manufacturing facility whose operating statement will benefit from the make allowance change. While their preference is to have all businesses seek cost recovery from the marketplace, they supported the make allowance changes and directed management to vote positively in the nine referenda votes where DFA had a ballot. But just as vocally they have asked their staff and management to support this hearing proposal because it does direct those businesses (many of which they are partial owners of) to look for a way other than make allowances as a better method for cost recovery.

DFA owns and operates plants that

condense milk in California, New Mexico, Texas, Colorado, Indiana, Pennsylvania and Louisiana for sale to third parties and for use in our own operations. In those areas our direct costs are in the range as outlined by Dr. Cryan in the construction of the Class II skim milk price formula, 6 to 7.5 per pound of solids. We have a variety of equipment and the cost range reflects that range. In some of these same plants and in cheese plants we operate, we frequently rehydrate non-fat dry milk for use in the plant. Our costs range from 3/4 cent to 1.5 cents per pound of powder. The cost range reflects that in some facilities we have invested capital to use a tote system which reduces labor, waste and product loss, while in others we empty bags which has a lowered capital cost but increased labor, product loss and cleanup and bag disposal costs.

DFA manufactures butter and several concentrated milk-fat products at plants in California, Texas and Minnesota. Additionally, we operate and manage a very large and substantial cream common marketing agency. I surveyed staff members in all four businesses and none were aware that any traditional Class II product manufacturers purchased butter or concentrated fat products for regular use in Class II products. They noted that large volume plants desired cream as an ingredient because it contained other milk proteins and other solids in addition to butterfat, which had desirable product formulation characteristics and the fact that it was already in fluid form was a benefit in the manufacturing process.

DFA markets milk to fluid use buyers in every Federal Order except Order 1131. Our costs to serve those markets have risen dramatically as a result of energy costs. Some of those costs are offset with negotiated premiums but in no case is the full cost covered by either a negotiated premium or by an Order transportation credit.

DFA has supported either the institution of, or modifications in, Order transportation of credits in Hearings for Orders 32 and 33 and in a request for a Hearing in Order 1. In Orders 5 and 7 we offered and supported proposals to modify existing transportation credits and institute new programs to offset increases in fuel costs.

Specifically, testimony in the Southeast Hearing, as referenced in our brief, noted two significant instances of increased cost.

The increasing volume of supplemental milk are documented in Hearing Exhibit 34 prepared by the Market Administrator. From 2000 through November 2005, the pounds of supplemental milk volumes on which transportation credit have been claimed increased constantly. Comparing month to month from 2000 to 2005: In July of 2000 there were claims on 31.7 million pounds; in July 2005, there were 107.7 million pounds; for August 2000 the claims were for 64.8 million; for August 2005 for 137.8 million; for September 2000, 78.3 million; for September 2005, 1117.8 million; for October 2000, 75.7 million; for October 2005, 127.9 million; for November 2000, 66.9 million; for November 2005, 98.1 million. The distances milk traveled varied from a 578 to 627 monthly average miles in 2000; in 2005 the monthly averages had increased to a range of 682 to 755. More milk for more miles requires more funding for the supplemental supplies.

Furthermore, the monthly cost of supplemental supplies has increased by an additional factor because of the increases in transport costs for milk. An estimate of the total monthly costs for supplemental milk in Order 7 over the periods since 2000 can be made using the Market Administrator's Exhibit of pounds on which the credits were claimed; applying the marketing average Class I utilization of 65 percent (which represents a portion of deliveries on which credits apply); and using the average cost per loaded mile documented by Mr. Simms. The result is that in 2005 the gross cost of transporting supplemental milk in Order 7 was two to three times as expensive (using the months of July through November for which there is complete of record evidence).

Due to fewer farms and declining milk volumes in the Southeast, increased mileages necessary to service markets and increased diesel prices, the costs to serve fluid use markets have increased. This phenomenon is consistent in all markets.

While some of these costs are offset by negotiated premiums they are insufficient and it is very difficult to match the volatility exhibited by energy costs. With regard to the Order provisions of transportation credits, they are deliberately set below costs in line with the philosophy of order minimum values. They only apply to the Class portion of a load of milk, while costs are based on full load factors. They are constructed based only on changes in fuel costs even though other costs have changed. In the southeast they only apply for part of the year and only supplemental milk supplies. In everyday commerce, the costs are year round and on every load.

Because of the size of farms and the rising number of cows necessary to cash flow a new operation, increasingly farms are being located further from metropolitan areas necessitating increased costs to service the processor. As processing plants get larger in volume processed, the incidence of any processing schedule less than seven days of either running or receiving milk pushes up balancing costs. Even the normal flow of holidays and seasonality become more expensive to deal with as plant capacity increases. Balancing plants in many parts of the US are few in number and small in capacity when measured against the dedicated manufacturing facilities of the Upper Midwest, the Southwest and West. As they close due to low volume driven inefficiencies the miles necessary to reach the ones still operating increase.

Emergency conditions.

There is a clear need for this record to proceed under the provisions for emergency rules. The industry expects the make allowance changes announced in November to be implemented by February of 2007. When that occurs all producers in Federal Orders will see

Order blend prices decline by approximately $0.20 per hundredweight from the make allowance change. This will not include any further price declines that usually occur seasonally at this time. Our testimony indicates that producer costs have increased to service fluid use markets. Increased costs and the February institution of a price reduction is a difficult combination for the dairy producer industry to deal with. Many producers would consider that combination worthy of emergency considerations.

The issues at this hearing are narrowly defined and the hearing scope is limited. All parties have ample representation in the room today. And I suspect as the week proceeds will demonstrate that they have ample data to supply for the record. We would request a tight briefing schedule of only a few weeks to be set by the Administrative Law Judge.

We thank the Secretary for calling this proceeding and we look forward to the final decision as the next step in the process of keeping Orders current with the industry

E. Hollon - Cross

needs.

MR. HARNER: We would ask that Mr. Hollon be accepted as an expert and Exhibit 25 be accepted in the record.

JUDGE PALMER: Does anybody wish to voir dire the witness before we accept him as an expert? Apparently not. So accepted, and his statement is received, Exhibit 25.

Questions? Mr. Lamers.

(Exhibit No. 25 was received into evidence.)

CROSS-EXAMINATION

BY MR. LAMERS:

Q. Good afternoon, Elvin.

A. Good afternoon.

Q. You've been around a little while, almost as long as I have. You are in agreement that the purpose for increasing the level of Class I prices is to bring a greater return to producers; is that correct?

A. That is one of the reasons for the formulas that are proposed today. That is not

E. Hollon - Cross

the only reason but that is one.

Q. Now, in your experience in which you have seen in pricing in the markets of manufacturing milk and the resulting increases in Class II treatment one milk, what causes these changes?

A. Which changes?

Q. The changes of the price levels, the commodity, the price levels of the Class III, Class IV prices?

A. Well, certainly supply of milk and demand for products, season, temperature, weather, holidays, those would be a mix of factors. In some cases they are even regulatory changes that affect them.

Q. And more interestingly, the supply affect the change in the prices, the supply of milk, the availability of milk and the availability of product. Is that what you're saying?

A. That would be a factor. It wouldn't be the only factor, but that would be a factor.

Q. Would you say it might be one of the major factors?

E. Hollon - Cross

A. Yes; I would say that would be one of the major factors.

Q. And when the price to producers at the Class III and IV level goes down, then you are saying that there is an excess supply of milk and that's what reduces those prices?

A. Some times that's the case and again some times seasonality, some times the time of the year affects that when the major supply demand conditions have been changed dramatically but there are some short-term arrangement. You may be between Christmas and New Year. There hasn't been any big change in demand, but prices may drop because it's that time of the year.

Q. And usually that's temporary. This is not a longer range of effect?

A. Some times, yes, up and down.

Q. Now, then if the milk supplies are reduced and the amount of product available on the market decreases, then that in turn drives the price up; does it not?

A. Yes.

MR. LAMERS: That's all I

have. Thank you very much.

JUDGE PALMER: Other questions? Mr. Tosi.

CROSS-EXAMINATION

BY MR. TOSI:

Q. Elvin, is it your testimony here today that DFA is experiencing an increase in the cost of supply and fluid in the market?

A. Yes.

Q. In response to a question I think here to Mr. Lamers, you said that your view of this was to also just to increase total dollars?

A. He asked me was that the reason for the proposal. I said I think there were two reasons for the proposal; one was to reflect the cost of serving the market, and the change since 2000, and also that we think it's worthwhile to change the formula method, and so that's why we're endorsing and supporting the proposal that it would change the Class I and Class II formula method, as well as to reflect some of the changes in costs.

E. Hollon - Cross

Q. Is any of this proposed $0.77 increase beyond the additional costs that are being incurred by your members that supply the fluid market?

A. I think, as Dr. Cryan outlined, it represents a mix of costs, and in most all cases there are costs on top of that, transportation costs. I think you heard from several dairy farmers who testified today about their particular operations and how they view cost, and none of them seem to think that $0.77 would cover all of their increases, and I think there have been questions from the floor about some of those costs that also would be greater than that.

Q. Does DFA either service to its member or to be aware of what is going on with its membership ever do cost of production surveys?

A. We don't do them directly. We have actually a couple of members who are in that business. So I routinely will look at some of their data that's published. Some of it is published -- some of those folks speak on a

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national basis and talk about cost of production data. Some of them published have accounting firms. I have one in particular. This firm represents 10 percent of the national's milk production, according to their own internal publications. And I have looked at some of their cost data, and it is indicated increases in costs from 1998 to present. Mr. Ginsky is the person's name. He is a accountant in California, and he's also a DFA member and he supplies some of that data. I also take a look at the ERS data. I'm not intimate with it, but I look at it from time to time, and I also look at the -- I always get the name -- Plesure, Orber and Stevens cost of production data. It's publically published, and again it indicates cost of increases.

Q. Is it the opinion of DFA then that the costs estimates here broken up by category that Dr. Cryan presented, that they are reasonable? That is also the opinion of DFA?

A. I think that is a reasonable way to establish the framework. It's difficult in these types of proceedings to come up with an

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exact way to do something. And so something that relies on government data that has some historical significance is probably a reasonable way to do something.

Q. Would it be accurate to conclude that what you are saying here in your testimony in the larger picture is that just as manufacturers had increased costs that we're considering in the hearing on the producer side of the equation of the increase costs they incurred should be also reflected in the minimum prices that we're setting in the Federal Orders?

A. Yes. That would be an accurate representation. I spent a lot of time last week in a board meeting trying to explain that exact concept.

Q. Why is that important?

A. Dairy farms look to see, for example, and explain make allowance hearings, and they can understand, most can understand the idea that they need a plant and it has to be some way of making that viable, but they turn around and say is there some way of making

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me viable. So I have attempted to explain before that it is very difficult to have just a cost of production formula and that's just a hard thing to do. Even back when I was in graduate school at LSU, there were opportunities in the State of Louisiana pricing program, and they were not successful, and it's difficult to identify all of the variables just by themselves, and it's extremely difficult to identify improvements in technology as they flow into that. So if you are going to recognize that, somehow you need a mechanism in the equation in the way to do that. In this particular proposal build on something that's already in the proposal system as a framework and provide some reasonable ways to look at those costs and provide some changes, and then you have the question if it's reasonable to look at the manufacturing cost, then maybe it's reasonable to look at the farm production in some form.

Q. What would be the harm if that wasn't the case?

A. In our current pricing formulas when

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we make changes in the III and IV prices because of costs structures -- I'm sorry -- you make changes in the III and IV formulas because of recognizing cost structures and you fail to do that and the other segments of, market, you began to get a disconnect, at least in our opinion, on how those formulas operate, and that's not a unique thing in the dairy industry. I think for a number of years California's pricing formulas have operated with make allowance in 4A and 4B but not in their Class I pricing structure. So we would be plowing and sowing new ground, and to have an opportunity to do something different and the conditions that result from the status quo are some elements of disorderly.

Q. That was going to be my next question. To the extent that we don't do that, would you be of the opinion that would give rise to less an orderly marketing condition?

A. That would be true.

Q. Why would you conclude that?

A. Especially in the eastern portion of the U.S. we're having a difficult time both

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attracting the milk supply and getting that milk supply from wherever it is produced in the pockets of production in the eastern parts of the U.S. over to the markets where it's demanding, and we think this proposal would at least help in that regard and help to perhaps draw some adequate supply and down the road there may be some ways to tailor some of the pool dollars to specific market services or not, but this would recognize some of the disconnect that we're beginning to see in the east versus west.

MR. TOSI: I think that's all I have for now. Thank you.

JUDGE PALMER: More questions? Mr. Lamers.

CROSS-EXAMINATION

BY MR. LAMERS:

Q. Elvin, you just stated that one of the reasons for increasing the Class I price was to offset the transportation costs?

A. Yes, sir.

Q. Did I understand that correct?

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A. Yes.

Q. Now, Class I prices charged to fluid milk handlers are subject to the pool?

A. Yes, sir.

Q. And any excess monies over and above the blend price that he are accumulated out of the price of the Class I milk goes into the pool?

A. Yes, sir.

Q. And the monies in that pool have to be paid to producers?

A. Yes, sir.

Q. With the exception of the cooperatives which don't have to pay big prices if they don't want to. So how does that cover what transportation costs where?

A. When the scenario you described you ended it with a period like the thought stopped, but the bill still arrived and some of those producers do have transportation costs to service that market such as deliveries to your plant, and the blend price doesn't always provide enough money to do that. And so as a means of identifying some of those costs in

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this proposal, one of the things that we've identified and it's been identified in other hearings are out to cover some of those costs so that when the blend price goes to the producers, it can be used to offset some of those costs like it is today.

Q. So you are relating this to the hauling charges made to producers; is that correct?

A. Both assembly and transport.

MR. LAMERS: Thank you.

CROSS-EXAMINATION

BY MR. HARNER:

Q. In your testimony you discussed a number of costs in supply and fluid market. Can you please discuss why you can't get all of those costs out of the marketplace?

A. That's always the constant question, and there would be perhaps a couple of reasons to identify, one, it's really apparent in the energy is that the premium structure can't always address volatility that's present in energy costs. Over the past year we certainly

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have fuel cost surcharges and adjusters at the premium level, and in some cases and in some months they may match the cost. In other cases they don't match the cost, and when things rise rapidly, it becomes difficult to always pass those on. So the attempt to recover some of those through the order price would be helpful. Secondly, it's just the overall relationship of premiums to prices and utilization levels in the market, and in some cases when markets have high Class I utilizations or even not so high Class I utilizations but high service cost, it gets to be hard to have a premium structure that covers all of those, because you have competing milk supplies that are perhaps able to avoid some of those costs, negotiate a deal and undercut some of the prevailing terms in the market, and so the answer becomes lower the premiums back to some level that doesn't always reflect cost. Another reason would be the ability or inability at times for dairy farmers and cooperatives to work together to service the market. I guess those are some of the same reasons why we have orders and blend price

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pooling, is to recognize that some of the costs of service and the various utilizations seem to be best for dairy farmers and the market if always shared and those don't always occur. So, yes, you can recover the cost of premium, but it's sometimes difficult to recover them all.

MR. HARNER: I have no further questions.

JUDGE PALMER: Yes, Mr. Yale.

CROSS-EXAMINATION

BY MR. YALE:

Q. Good afternoon. I want to ask you a couple of questions regarding the grade of milk. We have Grade A and there is Grade B milk; right?

A. Yes.

Q. Under the Federal Orders is there a requirement for milk to be pooled that it has to be graded A, or can it be Grade A and Grade B?

A. I'm not aware that Grade B milk can be pooled.

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Q. So whether the milk goes to a bottling plant or a cheese plant or a powder plant to qualify for participation in the pool it has to be Grade A milk; right?

A. Yes.

Q. Is there any reason to believe that a producer producing Grade A milk or a powder or a cheese plant has any different cost than one that's producing Grade A milk for an ice cream or a bottling plant?

A. In our experience there are some more stringent demands by the buyer in the fluid processing sector than in the manufacturing sector?

Q. And you and DFA sort out the higher quality producers from than the lower quality?

A. I don't think that was what I said. I said there are different demands by the buyers. Some buyers have certain demands that are higher than just the base Grade A standard.

Q. Do they pay for those extra standards?

A. Some times yes and some times no.

Q. But in this hearing we are talking

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about just two grades of milk, Grade A and Grade B; right? The Federal Order does not recognize Grade A or Grade A plus?

A. No, they don't.

Q. They only recognize Grade A?

A. But the cost some times of meeting Grade A plus are real nonetheless.

Q. So are you asking the Department to establish pricing to offset the cost of producers meeting the Grade A plus over just Grade A?

A. You asked me if there were differences in what buyers demand, and I said yes. Part of the proposal tries to identify cost of maintaining a Grade A supply and recognize the fact that those cost factors have increased since the reformed decision of 2000.

Q. And for producers whose primary delivery of milk is to a cheese plant have to meet those Grade A standards just as well as the others?

A. Yes, Grade A standards.

Q. And they have no discount in their cost because they are going to a cheese plant

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as opposed to a buying plant?

A. Ask that again.

Q. There is no discount to a producer producing Grade A milk to a cheese plant as opposed to Grade A going to a bottling plant?

A. Are you asking me just producers who delivers to a bottling plant on a consistent basis have some additional cost?

Q. No. The question is, that the hearing records have been talking about Grade A milk and the extra cost to produce Grade A, and that extra cost apply to all producers who are pooled.

A. Who are eligible to be pooled. They have to meet the standards to deliver to the fluid market.

Q. And because we have not all of our milk going into bottling, some times milk goes into other --

A. Right.

Q. Just because they go in another class doesn't mean they do not have to maintain those standards?

A. That would be correct.

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Q. Now, in today's cheese plants that we have most of those are designed to operate year around 24/7; isn't that correct?

A. In the main, yes.

Q. So they are no longer really a surplus market. They are a demand market in and of themselves; is that correct?

A. There is some flexibility limited, but in many cases they have characteristics of demand seven days a week, the bigger ones. They want some of the same delivery requirements.

Q. And there is some balancing costs some times associated with supplying those cheese plants; right? Make sure that they have that milk year round. You'll have extra milk some times the year that you have to move someplace else; right?

A. Yes. Although even with some of the larger plants there is some ability to negotiate some of that seasonality into their purchasing patterns.

Q. The same way with bottling plants. You can negotiate premiums and stuff for even

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receipts; right?

A. Yes. They are done on a little different basis but yes.

Q. And there is a transportation cost to move milk from the farm to a manufacturing plant just like there is from a farm to a bottling plant; right?

A. Correct.

Q. Is there any discount in the cost of transporting on a per mile per pound basis? Is there any discount by going to a cheese plant as opposed to going to a bottling plant?

A. No.

Q. So the same issues that are creating a need to provide producers more money in terms of supplying the market with the milk apply to a bottling plant as it does with a cheese plant?

A. I wouldn't say they are all the same, but you've identified some that are the same.

Q. Now, as it stands now, if there is in the market there is a Class I minimum Federal Order Class I price, I'm not going to

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say all orders, but in the Southeast there is an over-order of premium; right?
A. Right.
Q. Now, the minimum charge, whatever is paid by the plants under the minimum charge, is pooled and goes to all producers associated with that Order rather it's an independent or a cooperative; right?
A. When you say minimum charge, you mean order announced price?
Q. Order announced price?
A. Yes.
Q. But the over-order premiums that are collected by the cooperatives is not chaired shared with all producers in that market, is there?
A. That's correct.
Q. Now, do you have an opinion whether or not the increase in the $0.77 in the minimum price will be fully protected in a subsequent premium structure in the Southeast as a result?
A. I don't think anyone could predict that yea or nay with a certainty.
Q. So it's possible, it's not outside

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the realm of possibility that some or all of the $0.77 would be absorbed by the change in the premium structure?

A. I think it's likely that some may, and I think that it's unlikely that all would, and you could conceive a scenario where at six or eight months from now we find ourselves in a really tight feed grain supply scenario. Weather pattern is not dairy pleasant, and you may see that more, that market conditions may dictate.

Q. In the Southeast who handles the cost of balancing? Is that the cooperatives, the members of the cooperatives that supply that milk, or do all of the producers in the Southeast handlers that's servicing the market in terms of balancing and bring in the extra milk?

A. Primarily the members of the cooperatives that market collectively in the Southeast bear most of that cost, and the transportation payments are funded by in part by an additional assessment on Class I.

Q. But the $0.77 is not going to be a

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transportation credit. This is on the whole?

A. Right.

Q. And it goes into the pool just like the differentials do now; right?

A. Right.

Q. So the independent producers -- and there is a significant amount of independent milk in the Southeast; right?

A. Yes.

Q. They do not now, other than what little share they have in the transportation area, contribute to the cost of importing the milk in the short season and exporting the surplus milk in the long season?

A. They have no share of the transportation credits, in terms of sharing in that balancing cost, I think perhaps some of the independent producers. I'm not familiar with all of them, the marketing arrangements that they have. So you can say that some share and some don't. I think that there is some -- there is at least one or two, I don't know if cooperative is the right word, marketing associations that do share some of the

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balancing cost through their association.

Q. So I guess the question comes down to this point. Does $0.77 that is going to be on all of the Class I milk is in part going to go to producers who are not supplying and handling those extra costs of balancing the market as well as those that are?

A. Yes.

Q. In some cases it might actually reduce the amount of money available to the cooperatives who are supplying the market if, in fact, the order of premiums absorb all of that $0.77?

A. You made all of those scenarios. You could arrive at that conclusion.

Q. Now, in the notice of hearing it had language to the fact that these formulas could be adjusted based on changes and information regarding make and yield and pricing of the underlying commodities of butter, powder and cheese; right?

A. I'm not sure if that's exactly the way that it read. I think that's the way -- put it this way, that's what I thought it was

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suppose to mean. How about that?

Q. That would be great.

A. Is that when the proposal was submitted, the results of the first round of make allowance hearings were not known? Those were announced a week and a half ago, and that whatever those results were would be incorporated into the math and formula. I think Dr. Cryan, for example, in the back of his last pages of his statement, explained how the math from those formulas would be incorporated into the proposal.

Q. What is your understanding of approximate reduction in Class I prices that the make allowance decision has?

A. Twenty-five cents on Class I and 17 on -- I'm sorry -- on Class 13 and 17 on Class IV.

Q. So $0.25 on Class I?

A. Yes, in the case where Class III is primarily Class I --

Q. So are you saying then that in comparison to the price that exists here for December, the differentials that exist for

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December 2006 and the make allowance hearing does not here. They don't change. It stays at $0.25, the announced change, and you are asking for $0.77 here. You are really asking for a net of $0.52 over December's price as opposed to -- is that where we are at?

A. Yes.

Q. Now, in the event that that was an interim or a tentative final decision, right, on the make allowance; right?

A. Yes.

Q. Which means that there is at least one more opportunity for the Department to come up with another number; right?

A. Correct.

Q. If that other number changes in one way or another, are you expecting the Department also to reflect those changes in this Class I differential?

A. I hadn't really thought of it from that angle. I thought of it from the angle of if there is another make allowance hearing, that whatever changes might be there would not be reflected in this decision. I hadn't really

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given it consideration about this being a tentative decision, not a final. So that may be something we need to address in our brief.

Q. And then you are also aware that there is where we begun the early states of a process of more addressing the totality of the III and IV formulas in terms of the pricing product series and yields and developing makeups; right?

A. Yes.

Q. Is it your expectation that if the Department in the course of that hearing comes up with a change plus or minus to the product formulas for III and IV, that using Dr. Cryan's formulas in the back of his appendix that they would also make the summary adjustments to Class I?

A. No. I would not expect that. That would be another hearing, another docket and another process. That is not my expectation.

Q. We'll get an initial $0.52 rather than the $0.77. You are not sure how the final, final will deal with that. But it's your understanding that from then on, unless

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there is a specific hearing on I or II, there would be no changes to the Class I formula?

A. Correct.

Q. So if the Class III were to go down, then there would be a wider spread III and I, and if it goes up, there would be a narrower spread?

A. Correct. That there would not be another change to these formulas as a result of the next make allowance hearing.

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

JUDGE PALMER: Any other questions? Mr. Rosenbaum.

CROSS-EXAMINATION

BY MR. ROSENBAUM:

Q. Just to follow up perhaps on what Mr. Yale was asking you about. Steve Rosenbaum, International Dairy Foods Association.

Are you supporting a change to the current Class III and IV pricing formulas if, in fact, a hearing is held in the future that

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would incorporate automatic adjusters for change in cost of energy?

A. Yes.

Q. There is nothing like that, though, included in the proposal on the table today; correct?

A. No, there is not.

Q. So that as an example, if those changes were to be put into place for Class III and IV and a hearing be in January or February, for example, that would not pass through at all to Class I and II prices; correct?

A. That is not the way that I will see it.

Q. You're agreeing with me that that will not happen?

A. Correct.

Q. As a result, the potentially Class IV price and Class II prices could diverge more than nearly the result of your increase in the Class II price?

A. More or less. That's right. The relationships could change.

Q. And you said, for example, that when

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dealing with -- what percentage of your supply contacts do Class I handlers currently have in adjuster energy cost change?

A. To the extent if they have fuel cost surcharges it would be nothing.

Q. I'm sorry. None of them have fuel costs?

A. You asked me what percentage of our --

Q. Let me rephrase. Perhaps I will use your term to be a little more precise. What percentage of your supply contracts with respect to Class I handlers currently have fueling?

A. Many. I can't say if it's all. I don't know, but there are many that have fuel cost adjusters that move up and down on a formula. Some times they move and some times they don't. Some times they lag.

Q. And how often do they change? Is it a monthly thing?

A. There is not always a prescription of how often they change. Again, some times they change when the index change, and some times they don't.

Q. They don't because the index isn't changing?

A. Because negotiations for that particular month prevent them from changing.

Q. Do you some times renegotiate this on a monthly basis. Is that what you're saying?

A. I'm not sure I will say it that way. I think some times perhaps the buyer resists the change and they're not able to be passed through.

Q. And that's worked out as I suppose the relative bargaining positions of the companies are at that point in time?

A. By worked out do you mean that would be the end result in that particular month?

Q. Yes.

A. Okay, yes. That would be true.

MR. ROSENBAUM: That's all I have. Thank you.

JUDGE PALMER: Thank you, sir. You may step down.

BRIAN GOULD

a witness herein, having been first duly sworn, was examined and testified as follows:

DIRECT TESTIMONY

JUDGE PALMER: If you would give your full name. Do you have a written statement?

MR. GOULD: Yes, sir. I handed those out this morning.

JUDGE PALMER: We're going to mark your testimony or statement as 26, and if you would give your full name and a little bit of your -- give your full name. I see the first paragraph of the statement covers everything.

(Exhibit No. 26 was marked for identification.)

MR. GOULD: My name is Brian W. Gould. I'm a professor at the University of Wisconsin in the Department of Ag Applied Economics.

First of all, I would like to thank the opportunity to talk today and would also like to note that this is my first time appearing at a hearing, so please be gentle on me.

As I indicated, my name is Brian Gould. I'm an Associate Professor in the Department of Ag and Applied Economics at the University of Wisconsin-Madison. I have held this position since January of 2005. Prior to that appointment, I was an economist with the Wisconsin Center for Dairy Research at the University of Wisconsin. This is a producer processor's state funded research organization primarily composed of two scientists and an engineer. I was the economist on staff. In that role I was the coordinator of the dairy marketing economist program with the Center, and I continue to hold that position, even though I have changed budgetary homes. I held that position since December of 1998, and prior to that position, I came to Wisconsin in December of 1986 from a factory position in Canada that I held for four years. At that time in December of 1986 I participated in the USDA survey of collecting cost returns data of dairy farmers in Southwest Wisconsin. In both my current and previous positions I've been extensively involved with the analysis of dairy market and have published a number of technical papers concerning various aspects of the Federal Order marketing milk pricing, the marketing of dairy products, risk management within the dairy industry and the structure of international dairy product demand. And also, I would like to add that I for the last eight years I have taught the graduate economist class in our department. So I have a little bit of knowledge about statistics and econometrics.

Your Honor, I have provided a copy of my resume to you and the reporter, but I have not included it to the general distribution. I just wanted to save a little bit of -- I don't know that it's relevant or not, but I do have a few copies if you are interested.

JUDGE PALMER: You got a lot of research papers.

MR. GOULD: I don't have a social life. And by the way, I have a Ph.D.

from Cornell University that was received in 1983.

First, I would like to talk about our static analysis of the proposed Class I and Class II price changes.

The disparate regional impact on producers resulting from the changes in the Federal Order Class I and Class II pricing proposed by National Milk is a major concern for us. To assess the disparity, my colleagues at the University of Wisconsin and I have conducted a static analysis of the impacts of the proposed changes. Ideally I'm one that likes to be prepared. I would have liked to have done a dynamic analysis similar to what USDA have done. But given the short time of notification of a hearing, we have not been able to undertake the dynamic analysis that takes into account supply and demand responses to the proposed changes. So we've done a static what if type of analysis.

In the basis for Emergency Consideration section of the proposal, the implied justification for making changes to the

Class I and Class II formulas is to offset some of the negative impacts of the Tentative Final Decision, which I'm going to refer to as TFD, of the make allowances associated with the determination of Class III and Class IV prices. As National Milk states in its application, and again all of this analysis was done using information provided in the Federal Register. So I'm a little bit out of date in terms of using the 70, $0.73 adjuster and the old new formula, but I don't think it substantially changes on milk conclusion. I've incorporated the numbers that were presented yesterday.

As National Milk states in its application, an expedited hearing and decision are necessary to provide a more complete consideration of the Class I and Class II price formulas. National Milk expects this fuller consideration will produce offsetting compensation in these formulas, and thereby avoid unnecessary and excessive reductions in producer income.

The question is whether the proposed Class I and Class II formulas would achieve the desired offset. That's the key. That's what we're trying to address here. To help answer this question we simulated the effects on producer revenue of imposing both the proposed changes in Class I and Class II pricing formulas and the Class III and Class IV make allowances identified in the recent TFD. We conducted the simulations for three Federal Orders representing the full range of class utilization: The Northeast Order which we represent as the average Order, the Florida Order which high class utilization and the Upper Midwest which is obviously high Class III. The following table, and I have a table in the report that summarizes -- well, provides the average class utilization in those three Orders observed during 2006. I'm sure everyone is familiar with that.

The Florida Order typically has highest Class I utilization and the lowest Class III utilization among Federal Orders. The Upper Midwest Order typically has the lowest Class I utilization and the highest Class III utilization, and I break that down for the four classes as well as for all market average, and, again, I used EMS as a source, of course.

For each of the three separate Federal Orders, we used monthly data for the April 2003 to October 2006 period relating to monthly producer milk class utilization rates, producer deliveries, Class I skim milk mover and butterfat advanced values, Class I differentials, announced FMMO Class II to Class IV prices, two-week NASS average butter prices to undertake the simulations.

We calculated weighted average order prices (weights are utilization rates by class) under current Federal Order pricing formulas. We then incorporated National Milk proposed changes in Class I and Class II pricing formulas as well as the TFD Class III and IV make allowance changes. After incorporating both proposed changes in order pricing formulas, we simulated order prices for each class and recalculated the weighted average price. Again, we are using this as a uniform price because we don't know what the uniform pricing would be under the new TFD Order and the new proposed Class I and Class II changes. Simulated values were compared with those actually observed over the April 2003 to October 2006 period, and we understand how unusual some of those months were over the last three years. So we at the end tend to poll some in 2006, because we think that's a little more representative in terms of the utilization rates in the minimum or none or little de-pooling over the last year.

It should again be emphasized that this is a static analysis, comparing actual prices with what would have resulted from the proposed changes in pricing formulas. The analysis does not account for any supply or demand adjustments that would result from differential class price changes. It has long been recognized that increasing Class I differentials has the indirect effect of decreasing the price of manufacturing milk. For example, going back to 1979 by Professor Buxton at the University of Minnesota, and I quote, "increasing Class I differentials encourages milk production, as described above. It also discourages fluid milk consumption by increasing fluid milk prices. The combined impact is to increase the amount of milk that must be used to make additional manufactured products to be sold in the manufactured dairy product market. These additional manufactured dairy products tend to depress the manufacturing milk market.

In more recent analyses by various USDA publication website they have reached similar conclusions, so this is a constant, if you will, over the last cost to thirty years.

Reduced fluid milk consumption combined with increased producer deliveries disproportionately increase the volume of milk for manufacturing milk, cutting Class III and IV prices more than suggested by the make allowance changes specified in the TFD, and this is backed up by the analysis provided by the USDA, and I will have some comment about that a little bit later on. These effects would differ across Federal Order, obviously. We do not again attempt to measure these changes, but they're significant. I provide three figures that show the time path of the change in simulated market average or order average prices over the April 2003 to October 2006 period.

Again, the price effects are measured as the simulated weighted average price with the TFD and NMPF formula changes minus the current weighted average price, and since the National Milk of Class I and Class II proposal would affect milk changes as well as minimum order prices, we compared results with and without milk payment reduction. Again, is this a debate whether the milk program is going to exist. USDA and their analysis did not assume that milk program will continue after August. Personally I'm not sure that is going to be the case. So we thought it would be constructive to look at the situation with and without milk. The results which incorporate the milk reduction pertain only to the milk that is eligible for MILC payments. That is as we estimated by state the percentage of milk that is eligible for the MILC, recognizing the

2.4 million per operation limit.

These three figures that I noted above emphasize the different regional impacts that result from proposed Class I and Class II changes. The highest positive net effect (without considering milk payment impacts) Florida obviously which has the highest Class I utilization. Negative impact are shown for the Upper Midwest in those months where there is no depooling. Again, just to give you some indication over -- I forget the number. During '06 the average class utilization in Upper Midwest was 73, 75 percent. There was some months because of depooling where in the Upper Midwest only three percent Class III milk over a steady period. So some of these conclusions or the patterns that you see in those figures are due to the depooling effect, but if you look at just from '06 or the latter part of '05 onward, it's pretty much no depooling.

Negative impacts are shown for the Upper Midwest in those months where there is no depooling. The influence of Class I utilization rates on producer revenues is clearly illustrated in the charts for the Upper Midwest Order - large net gains were observed during those months with abnormally high Class utilization rates, resulting from a significant depooling.

The $0.73 per hundredweight increase in the Boston Class I price resulting from the National Milk proposal yield lower MILC payments. The lower panel in each of the figures show the net impacts after deducting the reduction in MILC payments. After accounting the milk payments there is shifting down of all profiles, which are not surprising, for those months in which the milk payments occurred. For the Upper Midwest, consistently negative net impacts were obtained from May '05 to October '06, period.

I provide a table, Table 2, which summarizes the information in the charts for the abbreviated January to October 2006. There is no depooling occurring in this recent time so that milk utilization rates can be considered as reflecting more traditional delivery patterns. In addition to the impacts of the weighted average class price, we provide an estimate of the revenue impacts, calculated by multiplying the change in average price by producer delivery. So we took part of an estimate of the total monthly, average monthly order reference impacts.

Total Order revenue impacts are calculated with and without milk payment reductions, MILC payments, I should probably say that. The effect including MILC requires an estimate of the volume of milk eligible for payment, given the 2.4 million pounds per farm MILC production cap. Milk eligible for full milk payments were calculated for selected states by using NASS herd size distribution and milk production data for 2005. Critical herd size was defined as 2.4 million pounds divided by the average milk per cow for each state and range from 105 cows in Arizona to 186 cows in Kentucky. Herds smaller than the critical size were assumed to receive payment on total milk production and calculated as the state average milk per cow times the midpoint of the relevant NASS herd category. Herds larger than the critical size were assumed to receive payment on 2.4 million pounds of milk. A uniform distribution of herds was assumed for a break category. We had a break category that 2.4 million pounds and we assume uniform distribution within that category which happen to be 100 to 199 cows. Using this methodology, the percentages of milk eligible for payment under the MILC program were estimated to be Florida 18.6 percent; Northeast 64 percent and the Upper Mideast 76.1 of the total milk produced in those orders. And again, I gave a table summarizing the impacts on both per hundredweight and for total herd order where the numbers in parenthesis in lighter shades are negatives, and they don't show up as red on my xerox.

Given the static nature of this analysis, it can be considered a conservative estimate of the impacts the proposed federal order pricing changes represent. As indicated by the preliminary USDA analysis with respect to the impact on total Federal Order marketings, higher Class I milk prices will generate a positive supply response. This increase needs to be considered along with the participated decrease in the demand for Class I and Class II products as a result of higher retail prices for those products. An increased supply of milk and combined with decreased demand for Class I and Class II products means increased volumes of milk to Class III and Class IV sales. More cheese and NFDM will result in lower commodity prices and lower Class III and IV prices.

The anticipated decrease in Class III and Class IV prices resulting the NMPF proposal will negatively impact orders with relatively high Class III and Class IV utilization rates in another way should the MILC program be extended beyond its August 2007 subset. In Table 2 and associated figures we illustrated the negative impacts of the lower MILC payments due to higher simulated Class I prices. These lower payments then need to be coupled with Class III and Class IV prices. Again, because the MILC payment is paid on Class III and Class IV milk as well as Class I and Class II. This implies that producers in markets with high Class III and IV utilizations, producers will experience, one, lower market induced Class III and Class IV; and, 2, with a higher Class I mover, the difference between the Boston $16.94 Class I price and the mover is reduced which means small MILC payments in times of account "depressed" milk prices. That was our static analysis of the proposal.

I have a few more comments to the USDA analysis of the proposal. The USDA simulations of the effects of the National Milk Proposal provide an initial estimate of the impacts on both class prices and marketings. The results obtained by USDA demonstrates that increased total marketings and decreased Class III and IV prices would result in the adoption of the National Milk Proposal. It is our opinion that these simulated values represent very conservative estimates of the impacts.

The model structure used by USDA to simulate the milk supply response to the National Milk Proposal is achieved by separate response of cow numbers and milk yield by a change in the All-Milk price. So obviously a change in yield times a change in cows give you the change in production. The functional form used in the estimation of the determination of cow numbers is log-linear which implies that the resulting elasticity estimates with respect to a particular explanatory variable equals the estimated coefficient. This, in turn implies that the resulting elasticity estimates is constant and does not change with changes in the all-milk price, current herd size, et cetera. It's just due to functional formula used in the estimation. Using USDA's estimated nine-year average change in total marketings of producer milk and the change in the all-milk price resulting from the full National Milk Proposal yields an estimated "arc elasticity" of 0.027. The average elasticity, total elasticity of marketings over the nine-year period is 0.27. The reason I had to do it that way is because the functional form used in the yield calculations in terms of log response was not log-linear. I did not know if that elasticity varies, depending upon what's going on in terms of the other variables. So because it was a constant, I had to calculate the constant by using the average.

I have two comments concerning this supply elasticity, this .027 value. Given the constancy of the cow number elasticity, a majority of the related supply impact comes from the change in cow numbers. That is greater than 92 of the total production response as coming from cow numbers, not yield, and that in my opinion is surprising, because the cow number elasticity reported by USDA is .025, and that's obtained in the documentation that's been alluded to prior to the National Econometric Model used. Again, I obtained that URL for that documentation from the National Register announcement of this hearing.

The model documentation further indicates that there is a significant amount of variability in the estimated cow number elasticity, reporting what is known as a t-ratio of 1.2 associated with the estimate, and I provide a footnote on how to interpret that t-ratio and also what I mean by supply elasticity. Using the implied elasticity standard error, Table 3, I provided a table that provides the range of elasticity values at selected what we call confidence intervals. Remember we're trying to estimate an unknown number that is the elasticity. We're using data to tell us what that elasticity is. We can never estimate that elasticity with certainty. So there is always some level of uncertainty even though we come up with a point estimate. We generate what's known as confidence intervals that tell us, again, what our probability of having the correct but unknown parameter in this range. That's what's known as confidence intervals, and I provide the standard type of confidence intervals in Table 3.

Table 3 provides a range of elasticity values as selected confidence intervals. Note that at the 95 percent confidence intervals that's in the range of elasticity estimates using the USDA data we're over 99 percent certain or confident that the true unknown is elasticity is going to be in this range. The lower bound of the estimate is negative. Again, remember, I'm talking about the cow number of elasticity.

Given the low precision of the estimate for this major determinant of the overall estimate of milk supply response using a range of elasticity values instead of a point estimate would be related preferable in terms of the economic analysis of this proposal. In statistics we say that that estimate of the impacts has very little power, because there is no uncertainty about one of the key numbers driving that estimate. The question that needs to be asked is what would be the effects of the National Milk Proposal if the actual number of cow elasticity is at the extremes of the confidence intervals. Again, the more accurate estimate of the elasticity the smaller that confidence interval is you are more certain in terms of what that elasticity is.

My second comment on supply elasticity concerns a very low production response to price implied by the USDA value.

Even the upper bound of 95 percent confidence interval is 0.58. So my widest range at the most common used statistically range of confidence intervals at the most extreme the estimated cow number response is .058 which is considerably smaller than published medium long run supply elasticity estimates. Some of the estimates are shown in Table 4. That is I provide a table that are previously published in refereed peer review journals of supply elasticity. Again, it goes a ways back, but again they're refereed so they pass the test in terms of being looked at by other economists. The USDA nine-year average supply elasticity of .027 is only 12 percent of the smallest elasticity point estimate shown in Table 4. Again, I'm not saying I did a complete census of elasticities, but these were typically the ones -- when I kept on looking, these were typical values that I came up with.

Given the magnitude of the difference between the USDA supply elasticity value and other estimates, a sensitivity analysis should have been conducted to examine the impacts of larger elasticity values, especially when you take into account of the indirect effects on Class III and Class IV markets and the effects on the Class I market in terms of increasing the --

Let me back up. Let me just say in terms of the impacts on the Class III and Class IV markets on the supply side, because you're going to have extra milk floating around that needs to go into manufacturing products.

Using larger supply elasticities would have generated correspondingly larger supply increases in response to the National Milk Proposal, resulting in larger negative impacts on Class III and Class IV prices.

In summary, there is no doubt that costs for both dairy farmers and dairy plants have increased since Federal Order pricing formulas were last changed in April of '03. These increases have come about as a result of increased input costs, primarily energy related. Now, again, that can be debated, but the bottom line is we all recognize the cost of increases. All dairy farmers have seen their costs escalate; the cost increase is not related to Class I utilization. I'm talking about a farm loader. Therefore, it's hard to understand why offsetting price relief should be offered proportional to Class I use. This is precisely what the National Milk Proposal does. That concludes my comments.

JUDGE PALMER: I have a feeling that there is going to be a good bit of questions. We just might stop now. Let me just get a show of hands. We have questions.

Let's recess until nine o'clock tomorrow morning.

(Whereupon, the above-entitled matter was concluded at 4:55 p.m. this date.)

C E R T I F I C A T E

I hereby certify that the proceedings and evidence are contained fully and accurately in the stenographic notes taken by me on the hearing of the within cause and that this is a correct transcript of the same.

S/Monica R. Chandler

Monica R. Chandler