USDA - FEDERAL MILK ORDER HEARING

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

Wednesday, December 13, 2006
9:00 a.m.

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

TRANSCRIPT OF PROCEEDINGS

VOLUME III

Reported by:

Tricia M. Clegg
Professional
Reporter

APPEARANCES:

U.S. Department of Agriculture:	Office of the General Counsel by Garrett 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
National Milk Producers Federation:	Roger Cryan, Ph.D., And Kevin 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; Midwest 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.
National Milk Producers Federation:	Roger Cryan
Dairy Programs USDA:	Clifford Carmin
Associated Milk Producer:	Neil Gulden

I N D E X

WITNESS: BRIAN GOULD

WITNESS: GARY LEE

WITNESS: DENNIS TONAK

P R O C E E D I N G S

BRIAN GOULD

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

EXAMINATION

BY JUDGE PALMER:

Q. Dr. Gould, you are still under oath. Doctor, you were telling me that when we met in the hall that there's a figure or two that you wanted to correct.

A. Yes, sir. Your Honor, we all know that economists are never wrong.

Q. Of course not.

A. This is one case where there has been a mistake. In the latter third of my presentation, I alluded to the calculation of total elasticity, supply elasticity based on a nine year average value displayed in the technical appendix to the hearing notice.

At that time I gave a total supply elasticity of .027 as my best guess, again, given the limited documentation contained in the model. In preparing for today's

Dr. Gould - by Judge Palmer

cross-examination, I relooked at my numbers, and I misplaced the decimal point in that calculation. It should be .269, not .027, but .0269. I apologize for that mistake. I was surprised by that number because of the relatively low elasticities, direct elasticities displayed, again, in the documentation.

So that's the correction I would like to make, and it doesn't substantially change my comments contained in the testimony.

JUDGE PALMER: Good enough. Now, who is examining you? Or let's see. I guess we just stopped, and we didn't really decide who was going to start. And I see Mr. Vetne looks eager to -- no. Somebody else is. Mr. Rosenbaum. And, again, we're going to have a new court reporter each day. So each day, if you don't mind, giving your identification.

MR. ROSENBAUM: Steven Rosenbaum for the International Dairy Foods Association.

Dr. Gould - Cross by Mr. Rosenbaum

CROSS-EXAMINATION

BY MR. ROSENBAUM:

Q. I see from your statement that you said that you did not have enough time to do the kind of analysis that you would like to have done, correct?

A. That's correct.

Q. And the kind of analysis you would have liked to have done would have been what you called a dynamic analysis; is that right?

A. Yes, sir.

Q. Which would take into account not only the sort of formulaic calculations of how the minimum price was changed, but actually an analysis of how supply and demand respond to those changes, correct?

A. That is correct.

Q. Do you view that as being a -- that kind of analysis being critical to the ability to reach rational conclusions as to the ultimate effect of this proposal?

A. Yes, sir, I do.

Q. And was the amount of time allotted

Dr. Gould - Cross by Mr. Rosenbaum

between the announcement of this hearing and the holding of this hearing sufficient for you or any other reasonable economist to perform that kind of analysis?

A. If one had an off-the-shelf type of model, the types of changes being recommended could easily be incorporated into a model, but for myself, I do not have a standing econometric model of the U.S. dairy industry. It would take a considerable amount of time.

Q. About how much time would you have needed?

A. Again, it depends on my knowing of my colleagues as being perfectionists, set by some of my desires for being as accurate as possible, I would say full time, probably two months.

Q. Now, there was a model presented in the hearing notice, correct?

A. Yes, sir.

Q. Did that provide any analysis of the regional impacts of the proposal?

A. No, sir. And that's one of the short-comings of the model. If I was to

Dr. Gould - Cross by Mr. Rosenbaum

undertake a model development, I, at least on the supply side develop -- because those numbers are relatively easily available, develop supply responses on a federal order basis, and somehow because we have -- the demand numbers are only available on the national basis, somehow coordinate that with the demand side and develop a little bit more of a flexible type of model to look at regional impacts.

But, again, recognizing that tie-in could be the difficulty and recognize that's why a lot of the people deal with only national types of models.

Q. It is reasonably achievable to do a regional-impact analysis you would say?

A. I would consider it a challenge.

Q. But one you think you could surmount?

A. I think so, and I think it could pass peer review.

Q. All right. Remind us what that means, peer review.

A. Professional economists.

Dr. Gould - Cross by Mr. Rosenbaum

Q. So you think other economists could review it and think it was good enough to be -- well, to be team-derived?

A. What I just indicated, I think, would be some frontier research and would be justified in terms of trying to publish in peer review journal articles, yes.

Q. Now, one of the -- I take it that part of your analysis is that the higher Class I price would increase the blend price obviously, correct?

A. That's correct.

Q. So one of the questions is to what extent would milk production increase as a result of that, right?

A. That's correct.

Q. And obviously a higher Class I price is not going to lead to higher Class I consumption, correct?

A. That's correct.

Q. In fact, one would reasonably assume the opposite, right?

A. That's correct.

Q. The higher the price, the lower the

Dr. Gould - Cross by Mr. Rosenbaum

consumption by whatever the consumer response is to the higher price, correct?

A. That's the way I was trained.

Q. And, therefore, there's -- well, that results in milk needing a home because there's less of a home in Class I consumption?

A. That's correct.

Q. And in addition, the higher blend price results in a response by the farmers, correct?

A. That's correct.

Q. And an increase in production if there's a higher blend price, right?

A. If we think that there's enough result in the supply curve, yes.

Q. Okay. Well, obviously it's not a finite resource, correct, milk?

A. That's correct.

Q. And that also results in more milk that needs a home, correct?

A. Yes, sir.

Q. And the home would be in manufacturing products as opposed to Class I or II products, correct?

Dr. Gould - Cross by Mr. Rosenbaum

A. I would say that's what the consensus is.

Q. All right. In fact, you cite a number of economists who reach that conclusion?

A. Yes, both historical as well as current.

Q. Obviously for those in the upper midwest, which is where you are located, that's a particular concern?

A. That's correct.

Q. Now, if I look at table 4 as corrected by you this morning, you list a number of supply elasticity estimates, correct?

A. Yes, sir, I do.

Q. And just to lay the foundation, as to I understand it, what that column is showing is what is the production response by farmers to a one percent increase in the price they are receiving for their milk; is that right?

A. Yes.

Q. And you have now indicated that USDA's model presupposes that for every one percent increase in the blend price, there will be a .269 percent increase in milk supply; is

Dr. Gould - Cross by Mr. Rosenbaum

that right?

A. That's the average response over nine years.

Q. And as I eyeball these other estimates that have been provided by you, that is very much on the low end of the supply response estimates that have been put forth by a variety of economists, correct?

A. I would characterize it as being reasonable as compared to the other estimates.

Q. Reasonable on the low end, correct?

A. Yes. But, again, as I tried to allude to, we have got to remember that these are point estimates, and there's a variance of those estimates, and you could be concerned about what variability on those estimates are, and I have no information about the variability on the other elasticities that I provided. I didn't have time.

Q. To the extent that these elasticity estimates that are provided here are higher end are reliable, those would tend to indicate a larger increase in milk production resulting from the increase in the blend product; is that right?

A. That is a correct interpretation.

Q. Okay. And, therefore, an increase in the amount of additional milk supply that will need to find a home, if, in fact, Class I price is increased, correct?

A. I think you can make that inference.

MR. ROSENBAUM: That's all I have. Thank you.

JUDGE PALMER: Other questions? Yes. Give your full name.

MR. CRYAN: My name is Roger Cryan, C-R-Y-A-N, with the National Milk Producers Federation.

CROSS-EXAMINATION

BY MR. CRYAN:

Q. Starting with the most recent thing. I want to understand and make sure I understand and get on the record that you have quite a bit of quantitative analysis on pages 9 and 10 --

A. Yes, sir.

Q. -- of your statement?

A. Yes, sir.

Dr. Gould - Cross by Mr. Cryan

Q. Almost all those numbers are based on your assumption that the supply elasticity was .027?

A. Not table 3. Table 3 is based on the cow elasticity, cow number supply elasticity which is given in the technical report at .026 or .025, somewhere.

Q. Okay.

A. I think it's labeled appropriately.

Q. But that's not the same as the -- these are not the same as the milk supply list?

A. No, sir, they are not. Those are just the confidence intervals on cow elasticity, the direct elasticity.

Q. So it's an example of the first step towards actually getting confidence intervals for the overall supply list?

A. Yes, it is. But, again, from my interpretation of the model -- again, I wish there was more. I wish the author was here. Total production is the product of the yield per cow to a number of cows, and that's only half the puzzle, but I did not have information to do a similar analysis on the whole totality.

Dr. Gould - Cross by Mr. Cryan

Q. The first part of your analysis regarding the impacts of this proposal and other things, can you confirm my understanding that your results don't break out the impacts of the NMPF all by itself?

A. That's correct. And I provided the reason -- initially I thought of doing that, but I -- reading the initial request for hearings, I thought it would be -- I wanted to answer the question of whether or not the proposed changes were enough to off-set the changes to the make allowance which was my interpretation of one of the reasons for conference.

Q. Do I understand that the MILC impacts that you have laid out show what would have happened in the past if our proposed changes have been in place then?

A. Exactly. And, again, if I may interrupt, assuming no changes in commodity markets, again, it's a ceteris paribus type of analysis.

Q. Ceteris paribus?

A. Everything else equal. Nothing else

Dr. Gould - Cross by Mr. Cryan

changes.

Q. On table 2 on page 4 of your statement, just to clarify this, the first three lines are expressed in dollars per hundredweight?

A. Yes, sir.

Q. And then without breaking the table, the next three lines are millions of dollars per month?

A. That's correct.

Q. And in the very last line is expressed as percentages?

A. That's correct. Yes, that's correct.

Q. You said this is your first federal hearing?

A. Yes, sir.

Q. Did you do this analysis for the purposes of this hearing?

A. Yes, sir, I did.

Q. Did someone ask you to do that analysis?

A. No, sir. I'm here as someone who has concern about the dairy industry and wants to make my contribution.

MR. CRYAN: Very well. That's all I have. Thank you very much.

JUDGE PALMER: Mr. Vetne, I think you were coming forward.

MR. VETNE: John Vetne.

CROSS-EXAMINATION

BY MR. VETNE:

Q. You examined, as I understand, the model documentation used by USDA for the analysis summarized?

A. That's correct.

Q. The model documentation was that which could be linked through the Internet provided to you?

A. Yes, sir. I may be mistaken, but it's the only verbal documentation I was surprised.

Q. Okay. And that model documentation provides an express number for cow number supply elasticity?

A. That's correct. That's the direct elasticity. Again, not knowing the dynamic

Dr. Gould - Cross by Mr. Vetne

structure of the model, I'm unable to determine how that elasticity is carried through multiple years, but at least the direct elasticity is given in the table.

Q. Am I correct that in examination of the model documentation, the model and as well as the analysis therefrom do not provide an expressed number for supplied elasticity?

A. Not total supply elasticity, no.

Q. That's a number that you have to calculate back into from some of the results reported from the analysis?

A. That's correct.

Q. And in backing into it, you came up with -- well, correcting your numbers, you came up with about .27?

A. Yes. And I need one more clarification. That .27 is for total federal order marketings. I also did it for total marketings from California and non-federal order areas, and the elasticity is .292. It's very similar. It's not surprising.

Q. What is the significance of that difference between .27 and --

Dr. Gould - Cross by Mr. Vetne

A. I can't say that they are different. It could be considered the same number.

Q. The objective of this kind of econometric analysis, I think you described earlier, is to draw a conclusion about the future based on lots of variables in changing only one or changing only an identified set of variables?

A. I'm not --

Q. You used the Latin term, ceteris paribus, all other the things being equal?

A. That was not the econometric analysis. That was my static analysis.

Q. Well, let's see. In the econometric model, we have a base-line projection?

A. That's correct.

Q. And then we have additional lines for changes from the base-line based upon changes in one variable?

A. That's correct.

Q. Or two variables?

A. That's right.

Q. In this case, the two variables are a change in the federal Class I price, a change

Dr. Gould - Cross by Mr. Vetne

in the federal Class II price and actually three variables, and in a combination of those changes?

A. They were separate runs. So they really could be considered for each type of analysis. A single variable is just how you package them.

Q. How you package. But as I understand the model or the objective of the model, it attempts to estimate the response, all other things being equal, from the change in just those price variables?

A. Yes. The only change is the -- those rules change, and then the models run and the endogenous variables are impacted. There's a feedback effect, and that's the linkage that I'm not aware of, within the structure of the model, what those feedbacks are, how that rule change affects the system. And it's not one variable change after the model gets going. It's all the endogenous variables allowed to change.

Q. Endogenous variables, could you give me an illustrative list of what those --

Dr. Gould - Cross by Mr. Vetne

A. Those are the variables that are attempting to be explained, and from a mathematical perspective, they are identified on the left-hand side of the quality of the milk supplies and function in price.

Q. Is milk supply commodity prices commodity supply --

A. Marketing production.

Q. Do you know from examining the analysis or the model documentation whether the USDA model analysis attributed the increase in -- propose increase in Class I or II prices to any milk supply other than that pooled in the federal order system?

A. Again, given the lack of detail, I don't know because, again, my investigation of the model, for example, cow numbers are function of all milk price, I don't know how the form of the prices were linked to the all milk price, and, again, I don't know, for example, how California is incorporating in the model. It has to be on the demand side, it's total U.S. demand. So this has to be a total U.S. supply. So, again, I'm not sure how the

Dr. Gould - Cross by Mr. Vetne

non-regulated areas are counted for in the model. That's the question I would like to see.

Q. But nevertheless, the proposal here that we're considering is a proposal that, by definition, enhanced the Class I price or the Class I price mover on milk regulated by USDA?

A. That's correct.

Q. And it would not then directly, that is USDA's regulation would not apply to, again, by definition to milk that's not regulated to other areas such as California?

A. That's my interpretation.

Q. Do you know whether the model in -- so you don't know whether the model incorporates, for example, observations of California regulatory responses to USDA regulatory responses such as if USDA Class I prices increase, we would increase ours?

A. There's no political component of the model. Again, this is pure speculation on my part, but I assume California pricing rules are in the model somewhere.

Q. In response to a question by

Dr. Gould - Cross by Mr. Vetne

Dr. Cryan referring to the MILC impact applied to, if the proposal had been in place, supplied in past years, your response was what would have happened in the past under the NMPF proposal?

A. That's correct.

Q. And your response about what would have happened in the past was a response that attributes no supply or demand change as a result of application of those prices to the passing?

A. That's correct. As I indicated, we didn't look at any changes in commodity markets which that was the case that would affect the price.

JUDGE PALMER: Do you have a point?

MR. BROSCH: Your Honor, just for the record, if counsel is going to ask him about what he testified before, we have no objection, but with counsel constantly paraphrasing what this gentleman's testimony was, the gentleman's testimony is a matter of record. So we have a problem with that paraphrasing, and I wish counsel would simply ask him questions about his testimony and not trying to paraphrase it.

JUDGE PALMER: Your comment is noted. I presume counsel has a right to paraphrase a little bit. So go ahead, sir.

BY MR. VETNE:

Q. Professor Gould, you do understand that if I'm paraphrasing, and I might paraphrase incorrect, that you can and will correct me?

A. Believe me, I would not be held back by not saying.

MR. VETNE: Your Honor, I do think it's more efficient to paraphrase than to have the reporter go back and try to find it.

JUDGE PALMER: I said go ahead.

Q. And it is not realistic, is it, in the real world to look at a -- well, a static analysis, you did a static analysis for the proposal as well as -- which you described for the past had it been supplied in the past?

A. That's correct.

Dr. Gould - Cross by Mr. Vetne

Q. It is not realistic in the real world to assume no supply response or no demand response to a change in prices?

A. Hopefully my comments alluded to that, that's correct.

Q. So nobody should conclude from your terminology of what would have happened to conclude that that is a possibility?

A. Well, we can never have a possibility of something that has already happened but --

Q. Well, let's --

A. It's not meant to be predicted.

Q. And in your testimony further referring to the static analysis on page 2, at the bottom of the page you used the phrase actual prices that would have resulted?

A. On page 2?

Q. Bottom of page 2, last paragraph, second line. Static analysis, actual prices with what would have resulted from proposed changes in pricing formulas. And along the same lines, same concept on page 4 in the first line referring to the static analysis could be

Dr. Gould - Cross by Mr. Vetne

considered a conservative estimate of impacts. Again, even though you used the term, conservative estimate and would have resulted, in the real world, supply response and the demand response, changes in prices happen, and those observations were made without considering supply and demand responses?

A. That's correct. I am sure that you can work over-bound for those over-bound effects.

Q. Is it true that in making supply elasticity estimates such as you referred to by various publications at the bottom of page 10, that economists look to behavior of markets in the past and try to convert that behavior into some kind of formula and then apply the formula to the future to estimate or predict what might happen in the future?

A. That's correct.

Q. And in looking to the past, is it typical to use a large number of years of behavior?

A. It depends upon the structured month.

Dr. Gould - Cross by Mr. Vetne

Q. The USDA model used a number of years before?

A. 24.

Q. 24 years?

A. 24.

Q. Okay. Is it common in use of such models to update the observations of past behavior to see if there's any change in supply or demand elasticities by more current?

A. Oftentimes when one estimates time series based models, you collect data, and you don't use all the observations, that is you keep the most current ones out of the estimation, and you estimate the model and compare your predicted values for those observations left out with what actually happened.

Q. Okay. So if I am an economist employing such a model and I started out with observations from, say, 1980 to 2000, would it be reasonable that in 2002 I adjust that to observations from 1981 to 2001 and then in 2003, observations from 1982 to 2002?

A. That depends upon the objective of

the model, and in general, it depends upon the commodity you are dealing with. If you are dealing with a dynamic environment which structural change is going on or other external factors, you may want to do that.

Q. Okay. And one reason for doing that is the elasticity of demand as well as elasticity of supply may change over time by, among other things, technology, management, competition for consumers, consumer preference, product alternatives, all those kinds of things?

A. That is correct, and hopefully one can develop a model that can recognize those changes within the model structure, and there's always a trade-off in data structure.

Q. If you use too short a period of time, say one year, you may be incorporating unusual responses and not have something that predicts --

A. Statistically you couldn't estimate a model.

Q. Okay. The more years you have, the better the statistic confidence?

Dr. Gould - Cross by Mr. Vetne

A. Not necessarily. Again, if there's, again, structural changes in the economy, if you don't structure the model correctly, you'll account for those.

Q. Okay. And do you know from examination of the model documentation or the analysis of the model employed by the USDA in this case and referenced in the notice of the hearing, how that model, if at all, captures recent changes in technology, economics, management practices and consumer preferences in its prediction of future behavior?

A. I don't have enough detail to make comments on that.

MR. VETNE: Thank you.

JUDGE PALMER: Other questions? Mr. Beshore.

MR. BESHORE: Marvin Beshore for the Association of Dairy Cooperatives in the Northeast and Dairy Farmers of America.

Dr. Gould - Cross by Mr. Beshore

CROSS-EXAMINATION

BY MR. BESHORE:

Q. Good morning, Dr. Gould.

A. Good morning, Mr. Beshore.

Q. If I understand you correctly in response to Dr. Cryan, you indicated that you were not asked to come here, you came on your own?

A. That's correct, and as my function as a university professor.

Q. So you would then be representing just yourself here today?

A. That's correct.

Q. Now, with respect to table 2 of your testimony which is what Exhibit 25 --

A. 26.

JUDGE PALMER: 26.

Q. That's a simple spread sheet calculated table?

A. Yes, sir, it is.

Q. And your computer is open in front of you today?

A. Your memory probably would be better

Dr. Gould - Cross by Mr. Beshore

than mine. So I wanted to make sure I give accurate estimates.

Q. Is the spread sheet loaded on your computer?

A. Yes, sir, it is.

Q. On table 2, the first line is the weighted average federal order prices through January through October of those three markets, and then the second line factors in two components as I read it; the effects of the temporary final decision on the make allowance and your projected effects of the proposals at this hearing today, correct?

A. That's correct.

Q. Now, does your spread sheet have a formula that tells us what the effects of the temporary final decision were on your estimates?

A. In terms of the effects on the -- let me back up. We use a procedure similar to Dr. Cryan in terms of getting the reduced formula, and we have in those figures the effect when those make allowances are given, and, again, I forget the gentleman from DFA

Dr. Gould - Cross by Mr. Beshore

that alluded to the effects of .25 or Class III and .174, Class IV.

Q. So Mr. Hollon's testimony with respect to 25 cents per hundredweight?

A. Yes.

Q. And those are the numbers that you used in your calculations?

A. That's correct.

Q. Can you tell us what the calculated impact just of the temporary final decision was for this period on these orders?

A. No, I cannot.

Q. Well, wouldn't that be, you know, one plus two, so to speak?

A. I would want to take time and redo the spread sheet. I did it in a single formula.

Q. But, Dr. Gould, the spread sheet is in front of you?

A. Yes.

Q. Open on your computer?

A. Yes, sir.

Q. The formula is TFD effect plus Class I, II effect?

Dr. Gould - Cross by Mr. Beshore

A. Okay.

Q. Now, you can take out the one and isolate it. You have got the multiplier right there. You have got the classes right there. You can do that in a very, very limited period of time, right?

A. I understand.

Q. Right now, could you not?

A. I understand that.

Q. Would you do that for me?

A. I would ask if you have done that?

Q. No, I have not.

JUDGE PALMER: Just what --

Q. I have not.

A. I'll do that, but I want to make sure that you recognize that I don't have time to make sure that I have done it correctly.

MR. YALE: Your Honor, can I object. I don't think it's a rule of cross-examination that we have people's spread sheets and they have to do calculations on the fly.

JUDGE PALMER: Why is it?

MR. YALE: Because instead, you are putting the witness in an extreme

Dr. Gould - Cross by Mr. Beshore

disadvantage. In the past we have allowed them to have time and come back, but to do it on the stand, I think, is --

JUDGE PALMER: Well, if he could do it, I don't see a problem. I'll overrule the objection.

A. If I may, let me look at -- again, my memory is not -- I want to do a quick perusal here and see what you have indicated is --

JUDGE PALMER: Can you preserve what you have? We don't want you to lose it.

THE WITNESS: I don't want to lose it either. No. No. It's not a problem here.

A. Just a second. Yes, I can do this.

Q. Okay. And what would be the impact of the temporary final decision on the weighted average price for the upper midwest order January through October 2006?

A. I was actually going to zero off the TFD. Is that what you want?

Q. I'm not sure what you mean by zero

out.

A. Make no changes in the make allowances.

Q. No. I want the make allowances to be incorporated, the changes in the make allowances to be incorporated in the order prices, just what you have done here, but you have also incorporated the proposed changes in this hearing. I want to isolate the proposed changes.

A. I misspoke because I would have to change the -- let me think here.

Q. Isn't it a very --

A. My assumption -- no, because I use -- let me just think here. In the spread sheet I use the proposed rules combined for the TFD, and in the columns that define the class I rules, I have no rules here. I don't want to input the old rules. I don't know what they are. I haven't memorized them. What I can do very easily is zero off the TFD, and you can see what the impact is of just changes in the make allowance or the Class I, Class II. That's the only thing I can do at this time,

Dr. Gould - Cross by Mr. Beshore

sir.

Q. Okay. That puzzled me just a little bit. Let's do some mental math. How about that?

A. All right.

Q. Can you tell me the approximate utilizations of the upper midwest order Class I, II, III and IV during January through October 2006 period or they should be --

A. Yeah. 76.1 for the upper midwest, Class I. Class III, it's in the table. I use the numbers that are in table 1.

Q. Yes. Thank you.

A. 75.0.

Q. 75 percent of the order is Class III. The temporary final decision reduced the Class III price by 25 cents per hundredweight, correct?

A. Correct.

Q. So, therefore, that would result in a 17.5 cent per hundredweight reduction in the uniform price?

A. If you are multiplying .75 times that number.

Dr. Gould - Cross by Mr. Beshore

Q. I want to have my mental math checked by --

JUDGE PALMER: Your mental math.

Q. By you, Dr. Gould.

A. I'm glad you have that much faith in me. Let me -- so if we take .25?

Q. Right.

A. I apologize for doing this. I want to be correct.

Q. I want you to be correct.

A. Times .75?

Q. Correct.

A. That will be 18.75.

Q. 18.75?

JUDGE PALMER: How much were you off?

MR. BESHORE: A penny and a quarter off.

JUDGE PALMER: There you go.

A. I'm glad I helped you out.

Q. Thank you. So the make allowance is just taking Class III effect on Order 30 and keeping everything else the same would have

Dr. Gould - Cross by Mr. Beshore

reduced the uniform blend price to producers up to 18.75 cents, correct?

A. That's correct.

Q. Now, of course, if those prices were in effect during January through October and Class III being the mover, it would have reduced Class I and II by the same -- or Class I -- I'm sorry -- by the same proportion, would it not?

A. Right, but we know -- let me think here. I think you are correct.

Q. Okay. 25 cents times 16.9 percent, how much additional reduction in price is that?

A. Okay.

Q. My mental math says 4.25.

A. And .169?

Q. Yes.

A. 4.23.

Q. 4.23. You have 18.75 cents plus 4.23. That's what, 23 --

A. Almost 23.

Q. 23 cents?

A. 22.98.

Q. 22.98 cents reduction in the uniform

Dr. Gould - Cross by Mr. Beshore

price. Now, class IV, 2.6 percent utilization was reduced 17 cents?

A. That's correct.

Q. That's going to be how much? Why don't you add Class II in, so that's based off Class IV.

A. So that would be 8.1?

Q. Correct, at 17 cents.

A. Bear with me for a second. 1.38 cents.

Q. So we had 22.98 --

A. I can add those up, if you would like.

Q. Yes, please.

A. That's where you were headed, right?

Q. Yes.

A. 24.35.

Q. Okay. So the make allowance changes, temporary final decision on the static analysis January to October of 2006 would have reduced the weighted average price in the upper midwest by 24 -- what did you say?

A. .35.

Q. .35 cents. When you input the

Dr. Gould - Cross by Mr. Beshore

proposals in this hearing -- the reduction according to table 2 of your testimony is minus 6 cents?

A. That's correct.

Q. Therefore, the proposals in this hearing would have added approximately 18 cents to the weighted average value on Order 30, correct?

A. I think that's correct. Again, you're --

Q. I don't want you to have any doubt about that. I want you to tell me that's --

A. If that's what we're doing of incremental change, I think that makes sense.

Q. So as Dr. Cryan testified, the proposals would have a positive -- these proposals would have a positive incremental effect upon all orders in the system, at least the ones you have analyzed?

A. I mean, again, given the type of analysis I have done that hasn't allowed a supply or demand response, if you are going to increase any price, it's going to increase everyone's.

Dr. Gould - Cross by Mr. Beshore

Q. I'm just breaking out --

A. That's correct.

Q. -- your table 2.

A. That's fine.

Q. So really if we're just looking at table 2 for this hearing --

A. Yes, sir.

Q. -- based on the regulations we have going into this hearing, the price impact of these proposals should be plus 18 rather than minus 6 on table 2, correct?

A. That's correct.

Q. Thank you. Now, let me just ask a couple of questions. And I'm going to get over my head really quickly here about the model and your comments about the USDA model, econometric models. On the supply side -- or in the model in terms of the calculations of what volumes of fluid milk would be sold in the future, what utilization of fluid milk would be if there were price increases. Okay.

A. That's correct.

Q. I'm looking at that. As I understand the documentation of the model, the

Dr. Gould - Cross by Mr. Beshore

model simply uses wholesale prices of products, not retail or consumer prices of products?

A. I think you are correct, and that's why I didn't comment on the demand side because in looking at the demand side, it's a lot more complicated because of the stage production you are talking about.

Q. So I am correct that it just uses wholesale prices?

A. Which tend to have lower, less than retail.

Q. Are you familiar with the literature which has documented rather -- well, has documented the disconnect between farm prices and retail prices?

A. I'm doing some work on that myself.

Q. And in fluid milk, for instance, and I'm not citing any particular study here, but I know that I have read or seen studies over the years that show some of the lowest areas in the country from fluid milk prices at the minimum federal order level, et cetera, occasionally and, perhaps, regularly show some of the high supermarket prices?

Dr. Gould - Cross by Mr. Beshore

A. That's -- could you repeat the question? I was sort of thinking about it as you were asking it. This is a different direction that you are going.

Q. Okay. You have indicated that you have done some work and seen some studies on the relationship between farm prices and retail prices, supermarket prices. With respect to fluid milk, have you noted in some of the literatures, some of the studies that some markets with low farm Class I prices tend to have higher supermarket fluid milk prices than other markets with higher farm prices have lower supermarket prices, and there's not a direct relationship?

A. I have noticed that pattern on occasion.

Q. Doesn't that pattern raise -- well, how does that pattern impact on the reliability of the demand side estimates in the econometric model when you are not doing anything with retail prices?

A. Again, remember, the econometric model is national in scope, and you just gave

Dr. Gould - Cross by Mr. Beshore

me an example of regional type of -- or local conditions, which in terms of that disconnect, it's sometimes due to market concentration on the retail side, which if you have regional demand models, you could account. Again, we have a national model. So it is a concern.

Q. Okay. Let me just ask one -- I just have one other question. If you have -- as I read your testimony on page 1, you have commented upon the implied justification for making changes in the Class I and II formulas. I'm in the middle paragraph.

A. Sure.

Q. As to off-set the negative impacts of them?

A. That was my interpretation.

Q. Okay. And that's why I'm asking. That's your interpretation. And in your summary in your final paragraph on page 11 --

A. That's right.

Q. -- you comment essentially assuming that to be the justification, you see a disconnect where the recovery, if you will, is regionally -- recovery of the losses from the

Dr. Gould - Cross by Mr. Beshore

TFD is regionally different?

A. That's correct.

Q. Now, wouldn't your thinking be different if you assume -- just assume with me --

A. Economists will make assumptions.

Q. Economists do make assumptions.

A. I have already.

Q. Assume with me that the justification for these proposals is not to off-set make allowance changes, but it is to update costs in the minimum federal order prices, costs embedded in the minimum federal order Class I and II prices, cost of the production is 70 and delivery of milk for those purposes in the system, assume there are costs embedded in those prices in the system and the purpose of this hearing is to update those costs from their cost base in the mid '90s to the present time. Wouldn't that have implied different comments in terms of what the outcome might be?

A. Given that that was not the sole purpose stated in the petition, I don't think

Dr. Gould - Cross by Mr. Beshore

that's a relevant question.

Q. Well, I'm asking you to assume, to assume that that's, you know, the purpose of the proposals --

A. If the --

Q. Just a minute. Assume that the purpose of the proposals would be as Dr. Cryan substantially testified, to update the costs that are embedded, embedded in those Class I or II prices.

A. If that was the objective, primary objective of this hearing, I would like the formula system that would incorporate region-specific cost structures instead of one national structure. You were making an assumption that every region base is the same cost increases. Again, assuming that that's the objective of the hearing, I would like to see a more flexible system developed that would allow for differential cost conditions.

Q. Do you have any suggestions on how it could be modeled that way?

A. I could make a lot of money if I did.

Dr. Gould - Cross by Mr. Yale

MR. BESHORE: Thank you. Maybe we all could.

JUDGE PALMER: Thank you, sir. Other questions? Yes, Mr. Yale.

MR. YALE: Benjamin F. Yale on behalf of Select Milk Producers, Continental Dairy Products and Dairy Producers of New Mexico.

CROSS-EXAMINATION

BY MR. YALE:

Q. Good morning. I want to follow up on that last line of questions about these embedded costs. Do you understand what the costs are that they are talking about that they increased? Do you recall that?

A. I do --

Q. This is an oral exam. So --

A. You know, I have been involved in the dairy industry for 20 years. I'm still learning, and I'm on the outside looking in. So I probably don't have as much knowledge as some of the people that have spoken today and will speak, but I am generally familiar with

Dr. Gould - Cross by Mr. Yale

some of the costs, but I can't provide a lot of insight.

Q. Have you been here through the hearing?

A. Yes, sir, I have.

Q. And you are aware that they broke down in the Class I differential some different elements that they believe in the changes in cost and --

A. I was able to follow.

Q. Do you recall what some of those elements were?

A. Transportation. No, I do not.

Q. One of them was transportation, was it not?

A. Correct.

Q. Now, that is the cost of moving the milk from the farm to the plant, right?

A. That's correct.

Q. Okay. Now, have you in any of your studies as you work in the dairy industry see that the cost, the relative cost to move milk from a farm to a cheese plant is any different from a farm to a bottling plant?

Dr. Gould - Cross by Mr. Yale

A. I have no information about that. I can't --

Q. Well, can you imagine why it would be different? I mean do you use the same fuel? Is there a difference in the way milk is hauled?

A. If I answer that, it would be just from a logical perspective. I don't know the answer.

Q. Do you know how much Grade B milk is in Wisconsin?

A. I think it's less than five percent. We have had discussions about that around the lunchroom. I don't know exactly, and all I know is it's a very small percentage. I don't know exactly.

Q. But that would mean that most of the cheese plants in Wisconsin receive substantial amounts of Grade A milk?

A. I would think that would be a fair assumption.

Q. And do you have any knowledge whether some cheese plants expect it to be Grade A milk?

Dr. Gould - Cross by Mr. Yale

A. I have no knowledge of that.

Q. Your testimony went -- I mean it talks about the elasticity that's in the USDA model, right?

A. Yes, sir.

Q. And your argument is it should be a larger --

A. My argument is that there's a lot of uncertainty about that.

Q. Now, based upon your knowledge and the research that you have done and where you think that you feel more certain that that ought to be, would that be a higher or lower elasticity?

A. To be quite honest, my experience in the past is more focused on the insight. I really don't know. I would want the data to tell me. I really can't say. From my examination, again, remember, I have limited information about the model structure which is looking at the values that are displayed there, and I want to say they look reasonable, but, again, that's a traditional statement given the limited information I have.

Dr. Gould - Cross by Mr. Yale

Q. So is the nature of your testimony just simply to say you have questions about the model, but you don't have answers to the model?

A. That's correct. That's correct. And it's a common problem I have with these models, that people interpret the numbers as given. These parameter estimates of elasticities are random variables. They have a variance. This is just their best guess of what those estimates are. There's always some uncertainty as to what the actual true value is.

Q. So it would be valuable to have somebody who was intimately involved in the model be able to answer some of those questions?

A. I would find it very easy.

Q. And that could have an impact of how those results of that model can be interpreted?

A. I think so.

Q. And how they could be weighed?

A. I would think that would be the reason for having such testimony.

Q. Is there any other information that

Dr. Gould - Cross by Mr. Yale

could be gained by questioning persons involved with that model that would be useful to analyzing and determining what that means to us?

A. I think a legitimate question is say, hey, how do you go from these initial elasticity estimates to tracking those changes through nine years, how does that translate. Again, my interpretation of the elasticities are something very small, but, again, if I just look at the number and then come out with some very large elasticities, and it's in that black box that I'm missing information.

Q. Is there anything else in that black box that --

A. I would like to know, as Mr. Vetne had indicated, how California is incorporated into the model, how the formulas are embedded in the model and how they translate to the all-milk price because the all-milk price seems to be the driver leading it in terms of supply side.

Q. And answers to that question could have a major bearing on the value and

Dr. Gould - Cross by Mr. Yale

usefulness of the model?

A. I would think so.

Q. Now, one thing in your testimony that doesn't seem to show too much uncertainty is your explanation of the impact of the two separate -- you know, the lower Class III, the higher Class I vis-a-vis the upper midwest. And I want to paraphrase. The question I'm asking right now, is this what you are trying to say, and that is is that producers in the upper midwest are going to receive a lower price for the manufacturing milk, somewhat off-set by higher Class I prices on the small amount that's into their pool, but at the same time because of changes in the dynamics, the amount of milk -- I'm going to break this up in parts.

Let's talk about the Class I. The impact on Class I has several impacts. First of all, it is an increase in the price, right?

A. I would classify it that.

Q. And that by itself, I think you have already testified, in simple economics 101, that means there should be less demand for that

Dr. Gould - Cross by Mr. Yale

product because the price went up, they'll have less move in that utilization, right?

A. Yes.

Q. Now, the milk, in your models and in your assumption that if the milk is not available, it is not being used by Class I, where would it ordinarily be accounted for?

A. Our stat analysis doesn't consider that at all.

Q. I know. But in the most dynamic, is there a consideration?

A. There has to be a balance in supply and demands.

Q. In the lower price classes?

A. That would be typically how it's achieved.

Q. So by raising the Class I price and you get a supply response, some of that increase will be off-set in a dynamic model, some will be off-set in part by the fact you are going to have less Class I to sell at that price, right?

MR. BROSCH: Your Honor, just for clarification, what dynamic model is

Dr. Gould - Cross by Mr. Yale

Counsel referring to?

MR. YALE: I said in a dynamic model.

MR. BROSCH: There's two models here. Which one are you talking about?

JUDGE PALMER: I don't think they have a dynamic. I think they are all static.

MR. BROSCH: Oh. He's talking about a model that doesn't exist, Your Honor? He's asking questions of the witness about a model that's not in evidence?

MR. YALE: That's an unfair characterization of what I'm doing, Your Honor. I'm asking him that in any dynamic model, how would this work.

JUDGE PALMER: We don't have a dynamic --

MR. YALE: We don't have one. I understand that. He's an expert and said he understands it, and I'm asking questions about it.

THE WITNESS: Can I make one comment? I would consider the USDA model a

Dr. Gould - Cross by Mr. Yale

dynamic model.

MR. BROSCH: But you are not referring to the dynamic model that the USDA put forth, Counsel?

JUDGE PALMER: Let's stop for a moment. Let counsel get his thoughts together. He'll rephrase it now.

BY MR. YALE:

Q. In a dynamic model, any dynamic model in the dairy industry in which you are considering the impact of an increase in Class I price, you would expect to see the value of Class I to go up? Wouldn't that be the first expectation?

A. Yes.

Q. All right. But you would also expect because of that value going up, the amount or the volume of product that goes to Class I would go down?

A. As a result of the demand conditions, yes.

Q. Right. Whatever amount that milk is would then move to lower class values, right, in the system? It would be priced at the lower

Dr. Gould - Cross by Mr. Yale

prices, the clearing price or the surplus price in the market?

A. I was looking at something else. Could you repeat the question?

Q. I'm sorry. First impact is the value of the Class I goes up, and in the raising of that Class I, there is a demand response that reduces the volume of milk moving into Class I?

A. That's correct.

Q. So the excess of that Class I that is now no longer demanded will move into a lower class product, right?

A. That would be my anticipation.

Q. Okay. Which would have a negative impact on the overall blended price, right?

A. I think by definition it would.

Q. And then in addition, by raising the overall value of the milk, you expect a supply response, right?

A. What kind of milk are you talking about?

Q. The milk from the farms, cows, raw milk.

Dr. Gould - Cross by Mr. Yale

A. Yes.

Q. All right. But all of that would then be also at the lower classes, right? That marketed milk would be at the lower classes?

A. It would depend upon as -- what I was looking at was the number from USDA. It would depend upon the relative supply and demand elasticities, the farm supply elasticity and the demand elasticity across the classes of product. So there's no definitive answer.

Q. There's no definitive answer?

A. No, sir.

Q. Okay. So what you are saying is that the class -- that if you raise the price of Class I, it may, in fact, result in more milk going into Class I?

A. No, I'm not saying that.

Q. You just don't know whether it would be into II, III or IV?

A. Exactly. I don't know how much lower the Class I utilization will be.

Q. Okay.

A. And I don't know what the supply elasticity is, how much extra milk is coming

Dr. Gould - Cross by Mr. Yale

forward.

Q. Information that would be helpful in analyzing the model?

A. Yes.

Q. Now, I want to come back to the summary of your statement. You talk about the upper midwest and its impact in general. I think it's specifically in general everybody else, is that they have lower value in their Class III and IV, and although there is an increase compensated, I think a few that you mentioned here, comes in at higher Class I, but because of raising that Class I differential so high, it removes the substantial amounts of MILC payments that they would be receiving, right?

A. That's correct.

Q. So that they get -- on the one hand, their overall price goes down because of the blended price with the Class III, but the recovery -- not recovery, but the remedy from the MILC program is also reduced, so they have a lower value of their milk but also a lower relief payment from the government for those

Dr. Gould - Cross by Mr. Yale

lower prices the way this is proposed?

A. From the order as a whole, yes, but from an individual producer, it depends upon whether he is receiving MILC --

Q. Right. But in Wisconsin the percentage of those receiving the MILC --

A. 76.1 percent, percentage of the milk.

Q. Right. I want to come back here in this last summary. It says, all farmers have seen their cost escalate, and the cost increase is not related to Class I utilization. So is your argument then if the farmer's cost that is the driving force to make this change, it ought to be able to do it so that all producers benefit as opposed to those with the higher proportion of Class I than III and IV?

A. That is my wish.

Q. Okay. Do you have any knowledge regarding the pricing structure above the order in terms of milk purchases in Wisconsin or Minnesota?

A. Are you talking about premiums?

Q. Premiums.

Dr. Gould - Cross by Mr. Carmin

A. I know they exist. I don't have any specific --

Q. You don't follow them on a specific basis?

A. No.

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

JUDGE PALMER: Very well. Any more questions? Yes, sir.

MR. CARMIN: Clifford Carmin, C-A-R-M-I-N. Dairy Programs USDA.

CROSS-EXAMINATION

BY MR. CARMIN:

Q. We have had some substantial discussions about USDA model. Referring to the documentation, would you agree with me that a title on the documentation in terms of the second line is a national econometric model documentation?

A. Yes, sir.

Q. Would that imply to you that's a national model?

A. Yes, sir.

Dr. Gould - Cross by Mr. Carmin

Q. And not an individual order model?
A. Yes, sir.
Q. In terms of looking at your presentation, you quote on table 4 a number of supply elasticity expectations?
A. Yes, sir.
Q. And I note in the line item, for example, behind the -- just after Cox, you indicate that's a 2001 publication, I assume?
A. Yes, sir.
Q. And other ones are earlier years?
A. Exactly. And years of publication, not years of data.
Q. Correct. Would you in your review of the documentation of the USDA model understand there to be an annual model?
A. Yes, sir.
Q. So in terms of the evaluation of these elasticities of the other models, do you understand them to also be annual models?
A. Some of them I do and some I don't.
Q. Okay. In terms of the USDA model, the results of the estimated supply elasticities, the demand elasticities from 1980

Dr. Gould - Cross by Mr. Brosch

to 2004, some 25 year period, would imply more current estimates of supply and demand elasticities than what you are indicating in the table?

A. Yes, sir.

Q. Thank you. Are you aware of any other model estimates or modeling work that would imply more current supply and demand elasticities?

A. Believe me, I -- again, given a short hearing notice, I searched the Internet and got on Google, but I'm sure there's some out there, not that I had the ability to look at in a cursory way.

MR. CARMIN: Thank you.

JUDGE PALMER: Thank you, sir. Yes, Mr. Brosch.

MR. BROSCH: Kevin Brosch on behalf of the National Milk Producers Federation.

CROSS EXAMINATION

BY MR. BROSCH:

Q. Dr. Gould, just to take you back a

Dr. Gould - Cross by Mr. Beshore

few minutes to your responses to questions with Mr. Yale. He asked you at one point about the workings of the dynamic model. Do you have a dynamic model with respect to the milk issues we're talking about today?

A. No, sir, I do not.

Q. So all of your responses with respect to that line of questioning are not based on any work that you have done?

A. That's correct.

MR. BROSCH: Thank you.

JUDGE PALMER: Yes, Mr. Beshore.

MR. BESHORE: Marvin Beshore.

CROSS-EXAMINATION

BY MR. BESHORE:

Q. Just one question. Did I understand that in response to one of Mr. Vetne's questions that you have some present studies in this area under way or you have --

A. What do you mean under way?

Q. Well, with respect to these proposals or the --

Dr. Gould - Cross by Mr. Beshore

A. Well, through the years I have written technical documentations concerning -- for example, back in '00 when we had the order, I have done similar types of analyses. I'm always kind of trying to look at the impacts of policy changes as they occur as quickly as possible, but I'm not quite sure what you are getting at.

Q. Maybe I misunderstood your response on the question.

A. I do not have, for example, a supply side analysis going on.

Q. If you were going to do policy analyses going forward, would you think you would want to segregate the -- for analytical purposes and discussion purposes, segregate the impacts of various sets of potential regulatory changes such as the make allowance changes versus class price changes?

A. Sure.

MR. BESHORE: Thank you.

JUDGE PALMER: Other questions? Yes, Mr. Tosi.

Dr. Gould - Cross by Mr. Tosi

CROSS-EXAMINATION

BY MR. TOSI:

Q. Good morning, Dr. Gould. Gene Tosi. I'm with the USDA. If the same USDA model that was used to provide a preliminary analysis of what the Department thinks the effects would be if the national proposal were adopted, that turns out to be the same model that was used to portray what the Department thought the effects would be of increasing make allowances, would your criticisms and identifications of the short-comings that you testified to here of the USDA model, would they be the same?

A. Yes, they would.

Q. Then how would that have challenged the validity of manufacturers coming forward with their proposal to have the price formulas be more reflective of what their manufacturing costs were?

A. I'm not disputing their -- I don't think that would have any impact on the validity of the proposals, but what it does -- what I do have certainty about is the impact

Dr. Gould - Cross by Mr. Tosi

analysis.

Q. Well, the impact analysis is something separate from --

A. Exactly. I understand.

Q. -- the evidence that says the costs were higher?

A. Right. So are you asking me to --

Q. I've asked you the question already.

A. Could you repeat the question, please?

Q. Okay. You answered if the model used to portray what the Department thought the effects would be of higher make allowances, if they were the same, you answered yes, you would have the same criticisms?

A. That's correct.

Q. I asked you then how does that challenge the validity of the evidence that says costs are higher?

A. They are not related.

Q. They are not related?

A. No.

Q. So then your testimony here has absolutely nothing to do with the fact that

Dr. Gould - Cross by Mr. Tosi

producers may or may not be incurring higher costs in supplying Class I?

A. That's correct.

Q. Thank you. Are you submitting your model for the record so that the Department can compare your study results to what the Department model indicates with respect to the effects of increasing Class I prices?

A. I'm not aware of what the usual practice is.

Q. Would you?

A. I have no problem with that.

Q. Are you submitting your report for the record? Right now you have you told us --

A. That's correct. That's correct.

Q. -- the results?

A. That's correct. I don't have a problem with that.

Q. Do you intend to?

A. Yes. I'll do that.

Q. When are you going to do that?

A. As soon as easily able.

Q. I'm a little slow sometimes. In your summary statement, you say that there's no

Dr. Gould - Cross by Mr. Tosi

doubt that costs of both dairy farmers and dairy plants have increased since federal order pricing formulas were last changed in 2003.

Are you aware that the cost component that's reflected in the cost that dairy farmers incur supplied in the Class I market is in part reflected in level of the Class I price to the differential, Class I differential?

A. That's correct, which was set in '03 -- '00, whatever.

Q. If it were based on an earlier time, that wouldn't substantially change your conclusion?

A. That's correct.

Q. If you are saying that all these costs of both manufacturers and dairy farmers have increased, and you attribute those in your testimony here to them being primarily related to energy?

A. I was going to -- I haven't done a survey of costs, but --

Q. Okay. Well, you say they're primarily energy-related?

Dr. Gould - Cross by Mr. Tosi

A. Right.

Q. You conclude that the cost increase is not related to Class I utilization?

A. That's correct.

Q. What does Class I utilization here have to do with the higher costs that you are saying that dairy farmers --

A. That's what I'm saying. It's not related to that. Why do you want to have a solution that where the relative impacts are based on utilization? The problem is ubiquitous across the dairy segment.

Q. Just as it makes sense, get a picture sort of thing --

A. Sure.

Q. -- if everyone's cost had gone up --

A. That's correct.

Q. -- and to the extent that all dairy farmers' milk is somehow -- you know, that's part of on the federal order regulation that it's pooled, then a portion of it is related to higher energy costs?

A. Except that has not changed.

Q. Sort of overstating here may be the

Dr. Gould - Cross by Mr. Yale

problem?

A. I don't think so.

MR. TOSI: Okay. All right. That's all I've got. Thank you.

JUDGE PALMER: Other questions? Mr. Yale.

CROSS-EXAMINATION

BY MR. YALE:

Q. Just some follow-up questions on the ones that were given. The question had to do that the USDA looked like an annual model?

A. That's correct.

Q. But it goes out how many years?

A. Nine years. We're displayed in the appendix.

Q. Based upon your testimony, there are short-term and long-term elasticities?

A. Again, this is a supposition on my part because I don't know the model structure.

Q. It would be nice to know how long, those eight, nine years, how long elasticity was?

A. Right.

Dr. Gould - Cross by Mr. Yale

Q. Now, the question about the impact, is there any difference in the cost of a producer producing milk if it goes into a Class III or IV market as opposed to a Class I market?

MR. BESHORE: Your Honor, that has been asked at least three times of this witness. It's just repetition.

JUDGE PALMER: Have you answered that question before?

THE WITNESS: I could give an answer now which --

JUDGE PALMER: Let him give one. I don't remember. Go ahead.

A. Could you ask the question one more time? I'm getting a little tired.

JUDGE PALMER: We want to get you off. I was letting this go so that when you finish, you finish.

THE WITNESS: I appreciate that, sir.

Q. Is there any difference from producer of milk and its cost to produce milk to deliver to a Class I market as opposed to a

Dr. Gould - Cross by Mr. Yale

Class III or IV market?

A. I have no information about that.

Q. When we talk about supply and demand and its impact on the price and the value of milk that -- I want to give a statement. I want to see if you agree with this. That is between parties of equal bargaining power, supplier and a buyer, okay, that the supplier is going to want to sell the product to exceed -- or at least meet or exceed its costs, and the buyer wants it low enough that it can with its extra added value be able to market it at above its cost, so that both par parties end up being profitable; is that correct?

A. We're assuming both parties are profit-maximizers?

Q. Right.

A. I would think that would be a reasonable assumption.

Q. Now, if for whatever reason the buyer is unable to pay the producers what the value of that milk is at the farm, if the focus is not on what the producer cost is, but the focus is on what the plant cost and its

Dr. Gould - Cross by Mr. Yale

profitability is, and that results in a number that the producers cannot profitably produce the milk, will that have a supply impact?

A. In the long run, it would.

Q. And in what way?

A. We have farmers exiting the industry, and you have a good supply to a certain degree. It depends what happens on the transition out of dairy.

Q. In a situation of raising make allowances that has that impact of reducing value to the farm can, in fact, have an impact on what the producers' profitability is and its supply and demand?

A. You could have a positive or negative impact.

MR. YALE: I have no other questions.

JUDGE PALMER: Anything else? Is this a necessary question? The doctor is getting pretty tired, and I hate to see you guys just repeat what you have gone over before. So I'm going to -- I caution you that I won't let that happen. Let's go ahead and

Dr. Gould - Cross by Mr. Vetne

see if this is something you truly need. Go ahead, sir. Mr. Vetne.

MR. VETNE: John Vetne.

CROSS-EXAMINATION

BY MR. VETNE:

Q. In response to cross, you referred to using the model, annual model, and in response to a more recent question, you made reference in that context to the nine years in the future?

A. That's correct.

Q. Okay. Your reference to annual model in response to those questions did not have anything to do with the observations of past behavior to determine a supply elasticity?

A. That's incorrect. It is based on annual data. So the observations are based on annual marketings, annual production, annual average class prices, what is based on annual data.

Q. It's based on annual data for a 24 year period?

A. 25.

Dr. Gould - Cross by Mr. Vetne

Q. 25 year period. Do you know whether the supply elasticity estimates from examining either the documentation or anything else have been refereed or peer-reviewed in the same manner as the other elasticity estimates that you cited?

A. I would consider them peer review because in the documentation it indicates that they passed the review process within the USDA.

Q. Do you know how that review process compares with academic peer review?

A. I have no information about that.

Q. Mr. Tosi referred to your model and the USDA model. Just to be clear, your model, whatever you refer to in response to that question, is not an econometric model of the kind that USDA uses?

A. No, it is not. There is -- it's not a statistical model. It's a simulation of what impact of analysis.

Q. So they are comparing what you did in a static model with what USDA did in its dynamic model?

A. I would characterize it as that.

Dr. Gould - Cross by Mr. Vetne

Q. Now, if producer costs have gone up as clear they have, and all producers, because of increased costs, yet higher prices, you plug that into a dynamic model, all producers in an aggregate will increase milk production, and prices again will fall; am I correct?

A. Until there's a new equilibrium reached. As to where that equilibrium would be, it would depend upon relative supply and demand.

Q. The objective of models is to try to find out where the equilibrium is in the future?

A. That's correct.

Q. And simply lowering Class III prices will -- if you use a dynamic model and in lowering all prices will reduce production which will increase Class III prices which will eventually reach an equilibrium? Let's take one step at a time.

JUDGE PALMER: Well, maybe we don't need to because he's gone over this before.

Q. Have you gone over this before?

Dr. Gould - Cross by Mr. Vetne

JUDGE PALMER: Yes. We have heard over and over again as prices go up, there will be more milk.

A. I don't mean to be confused by this issue because basic 101, but if your question on the logic is --

Q. No. The Judge said I can't repeat the question.

JUDGE PALMER: Yes.

Q. In addition to the elasticity models, you reference an organization called fat-free used as a dynamic model?

A. That's correct. To my understanding and is an annual model.

Q. Mr. Beshore asked you some questions concerning conclusions on, I guess, the static model on table 2, page 4. Just to be sure what your response is addressing here. The 24.5 cents reduction in federal order price that you and Mr. Beshore reached --

A. That's correct.

Q. -- that is --

A. 24.35.

Q. Pardon?

Dr. Gould - Cross by Mr. Vetne

A. 24.35.

Q. 24.35. That, again, is a static number and doesn't factor in supply response and price changes due to supply response?

A. That is purely the change in the aggregate make allowance weighted by utilization.

Q. It doesn't factor in any change in premiums just like with the Class I proposal applied, it doesn't factor in any reduction in premiums?

A. That's correct.

Q. It's simply the federal order component of arithmetic, not any dynamic market response?

A. Like I said, it's a very simple exercise.

Q. All right.

A. Simple as far as federal order pricing.

MR. VETNE: I'm done. Thank you.

JUDGE PALMER: Thank you. I don't think there are any other questions. So thank you very much, Doctor, coming forward. We're going to take a recess for about 15 minutes. But before we do, I would like to get some line-up as to who is -- this gentleman is going to testify next. Your name is?

MR. WELLINGTON: Robert Wellington.

JUDGE PALMER: Is Mr. Wellington's statement available for everybody?

MR. BESHORE: Yes. It was made available before the hearing.

JUDGE PALMER: Mr. Wellington's statement is back there.

MR. VETNE: Your Honor, yesterday I brought to your attention one Cooperative representative witness who needs to leave about noon.

JUDGE PALMER: Well, what do you think? What do you say? We'll be off the record to let them work that out.

(Short recess taken.)

JUDGE PALMER: Okay. Proceed.

MR. VETNE: Mr. John Vetne. I represent Mid-West Cooperative and others. Our

G. Lee - Direct by Mr. Vetne

first witness in opposition is Mr. Gary Lee from Prairie Farms. Mr. Lee identify yourself and your prepared statement.

MR. LEE: Yes.

MR. VETNE: Your Honor, has the statement been marked?

JUDGE PALMER: I marked Mr. Lee's statement as Exhibit 27.

(Exhibit No. 27 was marked for identification.)

GARY LEE

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

DIRECT EXAMINATION

BY MR. VETNE:

Q. All right. Mr. Lee, you identified where you are employed. Before you start, give a little background in your experience at Prairie.

A. I have been with Prairie Farms for 33 years, the last seven years as vice president of procurement, and in that role, I'm in charge of all of our procurement of milk, other dairy products, corn sweetener and sugar.

G. Lee - Direct by Mr. Vetne

Q. Okay. And among your responsibilities for Prairie Farms, does that include analysis of federal order regulations and its application to your members?

A. Yes.

Q. You previously presented testimony at federal order hearings?

A. Yes, I have.

Q. And analyzed other proposals as to their impact on your producers and how the dairy in your region impact is?

A. Yes. Yes, I have.

Q. Proceed with your statement, please.

A. My name is Gary Lee. I'm employed by Prairie Farms Dairy, Inc. as the vice president of procurement. I have been employed by Prairie Farms for 33 years, seven years in my current position.

Prairie Farms is a Capper-Volstead dairy cooperative headquartered in Carlinville, Illinois. Prairie Farms has about 800 member-owners located in Illinois, Missouri, Iowa, Indiana, Michigan and Ohio.

Through direct ownership and joint

G. Lee - Direct by Mr. Vetne

ventures, Prairie Farms operates 28 milk processing plants, four ice cream plants, two ice cream novelty plants, one butter plant and three food service warehouses. 27 of the 28 milk processing plants are regulated under the federal order system. Prairie Farms wholly-owned facilities located in Carlinville, Illinois; Peoria, Illinois; Quincy, Illinois where we have two plants; Olney, Illinois; Carbondale, Illinois; Granite City, Illinois and St. Louis, Missouri are all regulated by Order 32.

Wholly-owned facilities located in Battle Creek, Michigan; Fort Wayne, Indiana and Anderson, Indiana are regulated by Order 33. Wholly-owned facilities located in Holland, Indiana and Somerset, Kentucky are regulated by Order 5.

Joint venture facilities include: Muller-Pinehurst Dairy located in the Rockford, Illinois regulated by Order 30. Muller-Pinehurst is a joint venture with Mid-West Dairymen's Company. Roberts Dairy Company operates facilities located in Iowa

G. Lee - Direct by Mr. Vetne

City, Iowa; Omaha, Nebraska and Kansas City, Missouri, all regulated by Order 32. Roberts Dairy is a joint venture with Dairy Farmers of America.

Hiland Dairy Foods, LLC operates facilities located in Wichita, Kansas; Chandler, Oklahoma and Norman, Oklahoma regulated by Order 32 and facilities located in Springfield, Missouri; Fayetteville, Arkansas and Fort Smith, Arkansas regulated by Order 7. Hiland Dairy Company is a joint venture with Dairy Farmers of America.

Turner Dairy operates facilities located in Fulton, Kentucky; Covington, Tennessee; Memphis, Tennessee and Little Rock, Arkansas, all regulated by Order 7. Turner Dairy is a joint venture with Hiland Dairy Foods, LLC.

Prairie Farms belongs to both International Dairy Foods Association and the National Milk Producers Federation. Today Prairie Farms wishes to express its opposition to proposals 1, 2, 3, 4 and 5 as offered by National Milk. In fact, we do not understand

G. Lee - Direct by Mr. Vetne

why NMPF has taken up this cause. We always understood that the role of NMPF was to represent the best interest of all members of dairy cooperatives in an equitable manner but not to get involved in issues that pit region against region and help some dairy farmers much more than others.

We have always understood that the primary purposes of the Class I differential were to place a higher value on products with a relatively inelastic demand and cover the cost of transportation from points of abundant milk production to points of deficit milk production for Class I uses. We always thought that the Class I price was to be based on a price that reasonably reflected current market values of manufactured dairy products and thus the value of milk.

We will not attempt to discuss the elasticity of demand of Class I products. We will contend that Class I differential by itself ceased to be the only mechanism to move milk 30 years ago or more.

Transportation credits, pooling

G. Lee - Direct by Mr. Vetne

standards, assembly credits and over-order premiums help to attract milk for Class I uses where it is needed. Transportation credits, assembly credits and over-order premiums provide immediate compensation. Pooling standards can help to increase the uniform price. Thus, markets have already created a system that works reasonably well without tampering with Class I differentials or their historic basis.

Estimated changes to Class I prices contained in these proposals do nothing to address real world problems of attracting milk to Class I handlers. In the analysis of USDA, these proposals would raise Class I prices to 73 cents per hundredweight. I think that's now 77 cents. On orders with low Class I utilization, the uniform price would probably increase a few cents. On orders with high Class I utilization, the uniform price would undoubtedly increase, but the current system of transportation credits and over-order premiums would still be necessary to attract an adequate supply of milk.

G. Lee - Direct by Mr. Vetne

At the same time, if these changes cause dairy farmers in high Class I utilization orders to increase milk production over time, the net result would be more milk being utilized in manufactured dairy products. This would result in lower Class III and IV prices which would then result in lower prices for all dairy farmers. However, dairy farmers whose milk is pooled on orders with low Class I utilization would likely be harmed most.

As stated earlier, through various arrangements, Prairie Farms currently operates facilities regulated on five federal orders. In recent years, we have had no long-term problems attracting an adequate supply of milk, especially at facilities regulated by Orders 5 and 7. We have experienced temporary shortages that were more operational in nature than something addressed by these proposals.

Prairie Farms receives milk from about 800 members. In addition, we purchase milk from Dairy Farmers of America, Land O'Lakes, Mid-West Dairymen's Company, Foremost Farms USA, Associated Milk Producers, Inc.,

G. Lee - Direct by Mr. Vetne

Michigan Milk Producers Association, Southeast Graded Milk Producers, Arkansas Dairy Cooperative, Continental, Select and Zia at various wholly-owned and joint venture facilities.

None of these organizations have requested our support of these proposals. None of these organizations have suggested that without implementation of these proposals that they will no longer be able to supply us with milk.

That is not to say we are entirely pleased with federal orders as they exist today. In the last five years, we have testified at five hearings about these concerns. We have supported tightening of pooling and touch-base provisions of Orders 32 and 33. Those proposals were largely implemented. We have supported provisions to implement assembly and transportation credits on Orders 32 and 33. Those proposals were denied.

We along with Dean Foods proposed reconfiguration of Orders 30 and 32. We were

G. Lee - Direct by Mr. Vetne

trying to show USDA that the metropolitan areas of Chicago and St. Louis along with large areas of Illinois and Missouri were deficit milk production areas 50 weeks of the year. Yet those areas are regulated by Orders 30 and 32, while they more closely resemble conditions in Orders 5 and 7 in terms of supply-demand imbalance. Those proposals were denied.

Approval of Proposals 1, 2, 3, 4 and 5 will make it more difficult to procure milk for those areas. At the same time dairy farmers located in Illinois and Missouri will have an even greater incentive to take their milk to markets on Orders 5 and 7.

We simply do not feel that there is anything in these proposals that addresses real world federal order issues. We do not feel that these proposals will result in equitable returns for all dairy farmers in all regions of the country. One size fits all solutions usually have winners and losers. These proposals are no exception.

As I said at the beginning of the testimony, Class I markets have already created

G. Lee - Direct by Mr. Vetne

systems within the outside of orders that attempt to fairly and reasonably cover the costs of servicing those markets. Adoption of those proposals presented here will only create confusion and inequity among orders.

Q. That concludes your prepared testimony?

A. Yes, it does.

Q. Do you have any additional comments to make based on what you have heard since you prepared this testimony?

A. What I have heard so far only reemphasizes what I'm contending, that we're putting money -- that these proposals would put money in the wrong place, because the money would be diluted by the utilization of the order.

Markets long ago figured out how to attract milk when and where it is needed, and they have done so with over-order premiums. They have done so with assembly credits, transportation credits, tightening of pooling standards on some orders. The Class I differential is no longer the sole vehicle for

G. Lee - Cross by Mr. Beshore

attracting a supply of milk to market.

Q. When you used the term Class I differential now and in your statement, do you mean the same thing that Cryan referenced when he said the Class I mover?

A. Yes. I stand corrected.

Q. As long as we're understanding what you're talking about.

MR. VETNE: The witness is available. Thank you.

JUDGE PALMER: Questions? Yes, Mr. Beshore.

CROSS-EXAMINATION

BY MR. BESHORE:

Q. Good morning, Gary.

A. Good morning, Marvin.

Q. I have just maybe one question or two. If I understand your proposal or your comments correctly, Prairie Farms experiences a need in certain areas that you have identified as deficit to attract milk to your plants in ways that the current regulations do not do that?

G. Lee - Cross by Mr. Beshore

A. Correct.

Q. Okay. Now, wouldn't, you know, any enhancement of the blend price, as people have said, generate more supply in those areas incrementally?

A. Perhaps.

Q. To the extent that it did --

A. In a static environment.

Q. To the extent that it did, it would be -- you know, it would be incrementally beneficial to your needs in those areas?

A. Perhaps, but in Order 32 it would still be inadequate.

Q. And you base that comment on the utilization of --

A. On our utilization on Order 32.

Q. So in your view, you need more focused dollars on the Class I side of the market?

A. And that already exists.

Q. Through the old --

A. Through the old premium and fuel surcharges?

Q. But in areas where the assembly

G. Lee - by Judge Palmer

credits that you supported have not been adopted, those mechanisms are still inadequate, are they not?

A. I can't say because we don't have assembly credits on 32 or 33 where we have a large presence, and, again, those orders have covered and ensure falling covered cost by raising over-order premiums.

MR. BESHORE: Thank you.

JUDGE PALMER: I'm going to ask one question.

EXAMINATION

BY JUDGE PALMER:

Q. I saw on page, I think 2 of your statement, you stated about the middle of the page, at the same time, if these changes cause dairy farmers in high Class I utilization orders to increase milk production over time, the net result would be more milk being utilized in more manufactured milk products. This would result in lower Class III and Class IV prices which would then result in lower prices for all dairy farmers. It's the last sentence I want to ask you about. However, dairy farmers whose milk is pooled on orders with lower Class I utilization would likely be harmed most. Could you just explain that conclusion.

A. If we have more milk going into manufactured dairy products, therefore, going into Classes III and IV, which carry a lower value, the orders -- the low Class I, high Class III and IV utilizations would be harmed more than helped in the uniform price to the dairy farmers.

Q. So the blend price would be reduced?

A. Yes. That's my contention.

JUDGE PALMER: Questions? Yes, Mr. Yale.

CROSS-EXAMINATION

BY MR. YALE:

Q. Good morning.

A. Hi.

MR. YALE: Ben Yale for Select Milk Producers, Continental Dairy Products and Dairy Producers of New Mexico.

G. Lee - Cross by Mr. Yale

Q. Are you in a position to indicate how you believe the over-order premium and those charges will respond to this increase in Class I?

A. I have ideas about how I think they will respond.

Q. What would be your prediction?

A. Obviously they will still be necessary, and I would assume there will be very little, if any, reduction in over-order premiums should these proposals be approved.

Q. So the plants will be in a position to pass the pools from 77 cents on to its consumers or customers?

A. I believe that, yes.

Q. What impact then will that have on the supply, the local supplies for your milk?

A. Over time if uniform price were enhanced, you would assume there would be some more milk.

Q. If you are going to pass it on to consumers, are you expecting a loss in sales as a result of that higher price?

A. Logically you would assume that.

G. Lee - Cross by Mr. Yale

Q. Do you have any idea whether it would be a significant loss or just a --

A. No. As I said here, I'm not going to attempt to discuss price elasticity of the milk.

Q. So what you are saying really is that this extra 77 cents is going to producers but maybe not in the kind of way it needs to or --

A. It's not going to go to the producers who are serving the Class I market.

Q. Why do you come to that conclusion?

A. Because on low Class I utilization orders, the money will be diluted down so low and shared among those who are supplying milk to manufacturing plants, they will share in the benefits for doing nothing to serve the Class I market.

Q. So then the assembly costs and transportation costs and the cost to go from Grade A to Grade B that is being given to those producers will have no benefit on the Class I market?

A. That is correct.

G. Lee - Cross by Mr. Tosi

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

JUDGE PALMER: Very well. Other questions? Mr. Tosi.

CROSS-EXAMINATION

BY MR. TOSI:

Q. Thank you for appearing today. We appreciate it.

A. Okay.

Q. In your characterization of the National Milk's proposal as pitting one region against another, is that more important than having pricing formulas that more accurately reflect costs?

A. I'm saying that with these proposals, producers located on low Class I utilization orders are not going to benefit as much as producers located on high Class I utilization orders, and I'm saying that if there is a problem, the mechanism already exists outside of the federal order to fix it in the form of over-order premiums that are much quicker to respond to market conditions

G. Lee - Cross by Mr. Tosi

and where the money is directed at those who serve Class I handlers.

Q. In your capacity there with Prairie Farms, are your over-order premiums for Class I above the minimum Class I price?

A. All of our plants located -- or regulated by Order 32, our over-order premium right now is $2.01, and then an additional fuel surcharge on top of that that fluctuates with diesel, somewhere right now around 10 to 12 cents per hundredweight. That's over and above the Class I differential.

Q. So in the context of reality of what actually is being paid for Class I milk, then how would increasing the minimum Class I price as called for in the National Milk proposal, how does that end up pitting one region against the other?

A. The returns to dairy farmers located in the southeast would be much greater than those located in the midwest.

Q. And how do you conclude that if --

A. Based on their Class I utilization.

Q. I'm sorry. I was --

G. Lee - Cross by Mr. Tosi

A. Based on the Class I utilization of those orders.

Q. I'm sorry. I wasn't done asking the question. I apologize.

A. I'm sorry.

Q. If it's over-order premiums that really determine the price, what the actual price is going to be to the marketing conditions of --

A. Price or value.

Q. Or value. What is it then about increasing the minimum price that somehow undermines an accurate reflection of value?

A. Under these proposals, the order would raise the Class I price uniformly on all orders, but the returns would not be shared equitably among producers and all orders because there is variation in Class I utilization. If those supplying markets in deficit milk production areas need more money, there's a mechanism already available that is much more efficient and quicker to respond to market conditions in the form of over-order premiums.

G. Lee - Cross by Mr. Tosi

Q. Your statement, testimony here indicated that the opinion that the proposal tampers with the historical basis for Class I differentials, how does it do that?

A. I think this is providing a little bit of a disconnect between Classes III and IV and I compared to what we have now and compared to what we had under previous systems.

Q. In what way?

A. I just am of the opinion that we're trying to build something into the Class I differential to pay for things that are not the problem necessarily of consumers of Class I milk, the users of Class I milk.

Q. On that basis, what is your formal basis for determining the minimum Class I price?

A. I am suggesting we leave it as is at this time because, again, outside the order, systems already exist that can respond much more quickly to the needs of those supplying the Class I market.

Q. In your opinion, in the long run, on what basis do producers decide which market to

G. Lee - Cross by Mr. Vetne

supply?

A. Uniform price.

MR. TOSI: That's all I have. Thank you.

JUDGE PALMER: Questions? More questions, Mr. Vetne.

CROSS-EXAMINATION

BY MR. VETNE:

Q. Mr. Lee, in the middle of page 2 of your statement, you referred to the analysis of USDA and Class I prices set about 73 cents per hundredweight. You testified -- you inserted the word, now 77 cents?

A. That was the number that came out of Mr. Cryan's testimony Monday.

Q. Okay. But when you inserted, now 77 cents, you did not mean to imply, did you, that USDA had made any analysis at 77 cents?

A. No.

Q. That is the proposal?

A. Yes.

Q. Not the basis for USDA's analysis?

A. Right.

G. Lee - Cross by Mr. Vetne

Q. In the following paragraph of your testimony in the first sentence, you refer to farmers in high Class I utilizations to increase milk production over time. Did you there intend by increasing milk production to refer to an absolute increase or relative increase compared to what it would otherwise be?

A. Relative increase.

Q. And in response to questions from Mr. Tosi, you indicated that producers in high Class I markets would benefit the most and other markets would not benefit as much. Is that a static analysis or a dynamic analysis?

A. I think it's a dynamic analysis.

Q. Do you think that in low Class I markets that with the supply response as to the producers and --

A. Will you --

Q. The next paragraph, or the end of that same paragraph you said lower Class I would be harmed the most?

A. Due to the consequence of lower manufactured product prices dragging down

G. Lee - Cross by Mr. Vetne

Classes III and IV.

Q. So your testimony is that you believe that in some markets producers will have a net disbenefit?

A. Yes.

Q. In response to questions by Mr. Yale, as I recall, you indicated that in low Class I markets, the increased Class I price would be diluted and shared with producers who supply primarily Class III and IV. Whatever the utilization of a market, the higher Class I price will be diluted in every market by whatever the non-Class I utilization is?

A. Yes.

Q. And with respect to every market, every market that you are familiar with, there are additional costs incurred by those supplied in Class I plants?

A. Yes, there are.

Q. And none of the additional revenue that might be produced by these proposals are targeted to cover those costs incurred by those people?

A. No, they are not.

G. Lee - Cross by Mr. Vetne

Q. And when you incur additional costs without recovering additional revenue, producer supply in Class I markets actually may experience inequitably lower returns than producers who do not supply Class I?

A. That's the way I understand it, yes.

Q. And the proposal would do nothing to solve that?

A. No, it wouldn't.

Q. Your proposals which were previously denied for assembly credits and transportation credits would do something to solve that?

A. In my opinion, they would have provided some compensation to those who are serving Class I handlers.

Q. Is it your testimony that if there is inadequacy of supply to a plant, it ought to be addressed in a more fine-tune manner than a --

A. In a more market-specific manner.

MR. VETNE: Thank you.

JUDGE PALMER: Any more questions? There doesn't appear to be anything. Thank you very much, sir. You have

J. Vrieze - Direct

another witness I was told?

MR. VETNE: I don't have a witness that has an urgency at the moment.

JUDGE PALMER: Do you want to come forward, sir. Do you have a statement?

MR. VRIEZE: Yes. I prepared one but just --

JUDGE PALMER: Do you have a written statement?

MR. VRIEZE: No, not written.

JUDGE PALMER: Come up here. All right, sir. You were sworn. If you would give your full name.

JOHN VRIEZE

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

DIRECT EXAMINATION

BY JUDGE PALMER:

Q. If you would give your full name.

A. My name is John Vrieze.

Q. Spell the last name.

A. V, as in Victor, R-I-E-Z-E.

Q. Tell us a little bit about yourself, where you work or who you are affiliated with.

J. Vrieze - Direct

A. I'm a dairyman from Wisconsin, about 40 miles straight east of St. Paul, Minnesota. I thought it was important, but I know typically these hearings are reserved for economists and lawyers.

Q. No, they're not. We keep them open to everybody.

A. Typically. I'm also the president of the Dairy Business Association. It's an industry group that was formed about seven years ago in Wisconsin. Half of our members are producers. The other half are companies that support the infrastructure that supports the dairy industry in the State of Wisconsin all the way from processors to lender to key dealers. So I think we're a diverse group and have the best interest of the dairy industry in the State of Wisconsin.

I'm not trained as an economist. My last economic classes were 35 years ago when I was in college. I do get to practice economics twice a month when my milk check comes. Pending on the size of the milk check, it's either a static or a dynamic situation. Some

J. Vrieze - Direct

days it's elastic. Some days it's inelastic depending on the price of milk.

When I first read National Milk's proposal, again, I'm opposed to the proposal, they represent -- they suggest they're representing the welfare of 50,000 dairy producers in the United States. I would suggest they might have 50,000 producers that are members, but certainly the 14,300 dairymen in the State of Wisconsin would not benefit by this proposal.

So that's 20 percent of the nation's producer in one state that I don't think would benefit. I have friends like Dick Waybright, Mason Dixon Farms in Gettysburg, and I have friends like Don Benning in Florida right outside of Tallahassee that are high Class I utilization areas, and when the impetus for those folks to get higher prices for their milk based on an artificial ratio on this proposal, they are going to add cows. When I look at folks in Wisconsin like myself that are in a high Class III utilization area, friends like Donald Deyoung from the Panhandle of Texas,

J. Vrieze - Direct

we're going to get less for our milk. It makes commonsense. You don't have to be an economist, a full-time economist to look at what will happen.

We believe that in the National Milk's proposal, they start with a base of -- that it costs more produced Grade A than Grade B. Well, at the present time Foremost Farms which is where I send my milk for this year so far has paid about 90 cents more to Grade A producers than Grade B.

I asked the question before I came out here. Why is that? They said our PPD is, let's say, 25, 30 cents. I can understand you can't use that in the bottle, but why is it 90 cents, and essentially the answer about 15 minutes was because they can. So the market place has already determined the difference between Grade A and Grade B in that particular cooperative.

If you go to southern Wisconsin where there's some dynamic new cheese industry going on, they don't even differentiate between the price they pay to Grade A and Grade B

J. Vrieze - Direct

because they don't use the pool, they don't use the orders. They just buy the amount of milk and make cheese. So there, again, the marketplace determined the difference between Grade A and Grade B price. We don't need some formula from USDA to dictate how to start that out.

Talking about costs. I can't tell you, because I'm not good at making an economic model except on my own place, my costs for the first half of '06 to produce milk is about 8.5 percent greater than it was the first half of '05, and when I benchmark numbers with other folks across the United States, and I'm part of a pool of about 100 folks that benchmark numbers, our costs are between eight and 10 percent across the nation.

This, however, will not do anything to improve that problem. It's going to be supply and demand. If a bottle here in Pittsburgh needs my milk, it's an 11 and a half hour drive to get my milk here. So a guy that's an hour outside of Pittsburgh, he's got a 10 hour transportation subsidy, if you will,

J. Vrieze - Direct

to produce that milk or his incentive to produce the milk to put in the bottle is that transportation cost. It takes me 14 hours at my dairy to load a tanker load of milk. It would take 21 more hours to get it to Tallahassee, Florida.

So my friend, Don Benning who lives outside of Tallahassee, Florida, he's got about a 20 hour drive to buy my milk, an incentive, not a subsidy, but an incentive to produce the milk. If my milk needs to go to Tallahassee, Florida, Don Benning can give my coop a call, and guess what, that tanker is going to arrive there in 21 hours.

So, again, I don't understand why we need something artificially driving up that price. I can tell you after talking to those folks, if they were to get a 50 percent bump or a 75 percent bump in the price of their milk for that Class I -- because they are in a high Class I utilization, those folks are going to add cows. By increasing the price of that fluid milk, it's not going to increase the demand. It just makes commonsense that it's

J. Vrieze - Cross by Mr. Yale

going to reduce demand. And where does that extra milk got to come back? It's got to come back into a cheese bath which means I'm going to get less for my milk. So that was my statement.

JUDGE PALMER: All right. Questions? Yes, Mr. Yale.

MR. YALE: Good morning. Ben Yale on behalf of Select, Continental and Dairy Producers of New Mexico.

CROSS-EXAMINATION

BY MR. YALE:

Q. Good morning.

A. Good morning.

Q. You testified that the market is already differentiating between the value of Grade A and Grade B milk?

A. In the State of Wisconsin, definitely.

Q. What is your understanding between the difference in cost of operating Grade A or B? Is there any significant differences today?

A. It was about 45 years when we

J. Vrieze - Cross by Mr. Yale

updated from Grade B to Grade A. I know in situations in the State of Wisconsin, it's not just cost, but we've got a bunch of Amish producers. So that might be the reason that we have the Grade B producers in the State of Wisconsin, because for religious reasons, they don't believe in adopting some of the technology of particular grades.

Q. Do you have an opinion as to what the cost of those Amish have in operating their farms as compared to others?

A. I would guess their laboring costs would be significantly less.

Q. Is that where the most of the Grade B milk comes from in Wisconsin?

A. I don't have any -- you know, it was asked of Dr. Gould, or somebody asked Dr. Gould about how much it was, and he suggested less than five percent. It would surprise me if it wasn't substantially less than five percent of the total milk. It might be five percent of the producers, but I would guess substantially less than five percent of the total milk.

Q. But you don't know how that mix is

J. Vrieze - Cross by Mr. Yale

between the Amish?

A. No, sir, I don't.

Q. Now, there's been testimony regarding the costs of -- well, let me ask you. Do you know where your milk goes?

A. Yes.

Q. Does it always go to a bottling plant or a cheese plant or anything?

A. According to the guy that trucks my milk, about 98 percent goes into a cheese bath, 98 percent of the time.

Q. Otherwise, it goes to the bottle?

A. It might go to the bottle if it was demanded in a different area, but, again, 98 percent of the time into a cheese bath. When the demand is there either by rules in the order or the economic incentive to do it, it might get moved to a bottle.

Q. Do you get a forewarning that, you know, tomorrow your milk is going to the bottler? Can you do something different or --

A. No, absolutely not.

Q. You produce milk the same day after day regardless of what class?

J. Vrieze - Cross by Mr. Yale

A. Yes, sir. I might also add that up until four years ago, my milk had been going into a bottle. The two years previous to that, we made no changes in management style and also on our farm once it went to a cheese bath instead of to a bottle.

Q. Have you been here throughout the hearing?

A. Just came this morning. I was doing really important stuff yesterday. I was taking care of my cow.

Q. I would have agreed with that. Are you aware of any extra cost that are borne by producers who regularly ship to the bottle market?

A. No.

Q. Now, in your market are the plants paying a Class III price or are they paying more or less than that?

A. We typically call it basis which is anything we receive over the Class III price when we look at our milk check. That would include butter fat, proteins, premiums, PPD's, if you negotiate a volume premium with

J. Vrieze - Cross by Mr. Yale

somebody, all those things. It's been difficult actually this year to really make comparisons because of the regulations. Cooperatives are actually allowed to pay less than the stated Class III price.

So when you just compare basis between proprietary plants and cooperative plants, that's not a fair way to compare it. You have to look at how much less the coop possibly paid so that your net check -- I'm going to suggest that proprietary plants in the State of Wisconsin in the last year, year and a half have dropped their premiums by nearly a dollar.

So typically a proprietary plant would pay a little over a dollar, dollar and a half a hundredweight more this past year over Class III, and so then, again, if you take the net impact of what a cooperative can do on regulations, for instance, mine paid 28 cents under Class III for the base price this year. The basis looks really good, but when you take that 28 cents away, it all falls in there and can be as close to what proprietary plants

J. Vrieze - Cross by Mr. Yale

would pay.

Q. Are you saying you now are getting a dollar over and that's the market or that it was a dollar last year and they took that away and it's now at Class III?

A. On my particular farm I had arranged a contract for a year's worth of production. So I did not have that net impact. The folks that produce milk at my level had their premiums dropped by probably between 40 and 50 cents during the year. The premiums they have been receiving, that did not count for the butter fat protein, but just let's say the volume PPD's.

Q. So the net result is they are still running about a dollar over?

A. I would say that those have increased the past month or two. It might be closer to a dollar and a half. Again, that's for folks that haul their milk to a plant. Folks that are getting milk picked up, especially the small producers of the State of Wisconsin, their premiums would be substantially less than that.

J. Vrieze - Cross by Mr. Yale

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

JUDGE PALMER: All right. Any other questions? I'll tell you I'm going to need to take a break. So we'll make a five minute break, and then we'll ask questions. I want to get you so that you can go on your way.

(Short recess taken.)

JUDGE PALMER: Mr. Beshore, you have some questions.

CROSS-EXAMINATION

BY MR. BESHORE:

Q. I just have one or two maybe. Mr. Vrieze, my name is Mark Beshore. I represent the Association of Dairy Cooperatives in the Northeast and the DFA, Dairy Farmers of America.

I want to make sure and try to understand your thought process on this proposal. So that's the direction I'm going to go. Are you opposed to higher minimum regulated prices at your farm?

A. I'm not opposed to a bigger milk

J. Vrieze - Cross by Mr. Yale

check. I don't believe your proposal would give me a bigger milk check.

Q. Well, my question was a little different than that. Okay. Are you opposed to higher minimum regulated prices that apply to your production?

A. Again, sir, I don't mean to be an obstructionist, but my net milk check is what I'm interested in, and I believe the proposal before us today will have a net decrease in my milk check, and you might say am I opposed to a higher minimum price for the Class I. I believe a higher minimum Class I price will give me a smaller milk check because my Class III prices will go down, and 90 percent of my milk goes to Class III.

Q. Okay. Now, you're projecting that over an extended period of time, I take it?

A. I get another milk check on the 20th of December. That's the one I'm most interested in. For some reason, Dr. Gould, a couple of questions came forward to him, you know, who sent you here. Well, this morning was the first time I met Dr. Gould and talked

J. Vrieze - Cross by Mr. Yale

to him. I'm going to claim Dr. Gould I believe and what I read in here makes a lot of sense to me, and my tax dollars are actually going to pay his wages, and for once, I'm kind of happy a government official turned out like that.

Q. If you were here this morning when I asked him questions, you understand that he calculated that the proposals would have increased the minimum price 30 by 18 cents per hundredweight or so for January through October of 2006?

A. I understand that question. I understand his response.

Q. Okay. And you are opposed to that result?

A. If under that scenario that Class I went up 18 cents, but Class III went down 28 cents, my net milk check is lower.

Q. And it's your view of the prices in the marketplace that if the Class I price goes up, Class III price will immediately go down more than that to off-set it?

A. Quickly. My family has been in the dairy industry for 150 years. I wanted that to

J. Vrieze - Cross by Mr. Yale

continue. If my January milk check spiked just briefly, I would love that, but I'm going to suggest to you, sir, that over the long haul, my net milk check is going to be lower.

Q. You commented with respect to, you know, the market setting a price for your milk if it was demanded in Florida. Are you opposed to those relative prices being regulated other than the federal orders?

A. The Dairy Business Association that I'm the president of, and I'll represent them today as well as myself as an individual producer, don't see much value to the order system period for the folks in the State of Wisconsin. So if you are suggesting to me if the orders became deregulated and my milk can move to Florida freely, I would be for that plan.

Q. I'm not suggesting anything. I'm asking. Okay.

A. I understand what you are asking.

MR. BESHORE: I appreciate your comments. Thank you.

JUDGE PALMER: Any more

J. Vrieze - Cross by Mr. Yale

questions? Do you have another question?

MR. YALE: Yes, one quick one.

JUDGE PALMER: Sure.

CROSS-EXAMINATION

BY MR. YALE:

Q. In the context of the question about raising minimum prices and having an impact would -- in your view, the problem is that it doesn't reflect it on all of your milk, and, therefore, you don't get the benefit of the minimum prices, but other producers do, but you, on the other hand, have to share the cost of the excess milk without getting any benefit; is that fair?

A. Twofold. First of all, I ship my milk to Foremost Farm. They do have a bottling plant, but if I ship to a different cooperative, a different proprietary that was taking advantage of the pool, that milk might have to leave their plant as well to go to the bottom. A current situation, cheese plants -- there are certain cheese plants that are actually short of milk today. If they were

J. Vrieze - Cross by Mr. Yale

required by the pool to send fluid milk out, we would actually have a negative PPD on our milk check, and that has happened over the last couple years because of that procedure.

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

JUDGE PALMER: Other questions? Sir, thank you very much.

THE WITNESS: I appreciate you getting me up here.

JUDGE PALMER: All right. Let's look at our schedule. I guess it's time to take a luncheon recess, and then we'll be back at 1:00, and I believe Mr. Wellington is going to testify. We'll see you at 1:00.

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

MR. BESHORE: Thank you, Your Honor. I would like to ask that Mr. Wellington's statement, five page statement of testimony be marked for identification as the next exhibit.

JUDGE PALMER: 28.

(Exhibit No. 28 was marked for

identification.)

MR. BESHORE: 28. Thank you. I have just a question or two of Mr. Wellington before he proceeds with his statement.

ROBERT WELLINGTON

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

DIRECT EXAMINATION

BY MR. BESHORE:

Q. Bob, could you just briefly relate your educational background.

A. I have a bachelor's and master's degree in agricultural economics from Rutgers University.

Q. Have you previously testified in your field of expertise in various forums?

A. Yes, I have. Pretty much every federal order hearing in the last 17 years that affected New York, New Jersey, the New England order, the Northeast order. In addition, I have testified before congress as well as all the state legislatures, New York as well as the six northern states.

MR. BESHORE: At this time I

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would ask Mr. Wellington to proceed with his statement and ask his testimony be considered as an expert in the field.

JUDGE PALMER: Go ahead, sir.

A. Okay. My name is Robert D. Wellington. I serve as senior vice president for economics, communications and legislative affairs for Agri-Mark dairy cooperative. I have worked in that position for Agri-Mark for the last 17 years. Prior to that, I was employed by the Office of the Market Administrator, New York-New Jersey milk market area for 11 years. My position with the Market Administrator's office included senior economist and chief of research and cooperative relations.

Agri-Mark is a Capper-Volstead cooperative headquartered in Methuen, Massachusetts. We have approximately 1,450 members located in the six New England states and New York. We market about 2.7 billion pounds of milk annually. Our members own and operate four manufacturing plants including dedicated cheese plants in Chateaugay, New York

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and Middlebury, Vermont, a cheese and other dairy product plant in Cabot, Vermont and a butter and powder plant in West Springfield, Massachusetts.

I am testifying here today in support of Proposals 1 through 5 put forward by the National Milk Producers Federation. This testimony is given on behalf of the Association of Dairy Cooperatives of the Northeast (ADCNE). ADCNE consists of the following Capper-Volstead cooperatives: Agri-Mark, Incorporated, Dairy Farmers of America, Incorporated, Dairylea Cooperative, Incorporated, Land O'Lakes, Incorporated, Maryland and Virginia Milk Producers Cooperative Association, Incorporated, O-AT-KA Milk Products Cooperative, Incorporated, St. Albans Cooperative Creamery, Incorporated and Upstate Niagara Cooperative, Incorporated.

These organizations represent more than 65 percent of the milk pooled in Federal Order No. 1. The secretary has recently recognized cost increases which have been experienced by manufacturers of Class III and

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IV products in the emergency decision which we hope will be effective in early 2007. This will have the immediate effect of reducing the price of all classes of milk in the federal order system at a time when dairy farmers are experiencing some of the most severe cost-price pressure in my years.

We recognize that these adjustments in Class III and IV make allowances were necessary to maintain local outlets for producer milk, but it is now critically important to look at our federal order prices and make necessary and appropriate adjustments to the price formulas to account for increased costs on our dairy farms.

It cannot be disputed that all the factors recognized in the manufacturing make allowance also impact farm costs. Energy inflation is a particularly pervasive cost element at the farm level impacting the costs of all purchased inputs, including utilities, fuel, fertilizer and other costs. In the northeast, the cash costs of production are well-tracked by Northeast Farm Credit, and some

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of that data was presented separately by Scott Herring, the witness for that organization. The majority of the ADCNE cooperatives have membership represented in Northeast Farm Credit database. Roger Cryan has reviewed USDA cost of production data from the national perspective. These sets of data show one undeniable fact.

The cost of producing milk on our farms has increased materially since the current federal order prices were set in the federal order reform process. These cost changes must be recognized in the federal order class prices.

The prices of economic inputs used in the dairy industry have risen thereby increasing costs for plants that manufacture Class III and Class IV products, for suppliers of Class I and II milk and for farms which produce the milk needed for all plants. The make allowance hearing has attempted to address these costs associated with manufacturing. This was needed so that those plants can more likely cover their increased costs, stay in

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business and, thereby, provide local outlets for farm milk. Dairy farms must be treated with the same measure of concern if they are to stay in business. Class I price base needs to reflect appropriate cost increases which have occurred since the current level was established.

The National Milk proposals are thoughtfully crafted to build upon the federal order reform decisions. The proposals account for and update the elements of the Class 1 and II price formulas which are built upon production and marketing cost factors related to the Class I and II markets. These factors are particularly important in the northeast where Federal Order 1 is the largest market in the federal order system for both Class I and II utilization, representing 24 percent and 31 percent of the Class I and Class II volumes in the federal order system in 2005. As such, appropriate Class I and II price mover formulas are critical in the northeast.

The costs of servicing the more than 10 billion pounds of Class I and nearly five

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billion pounds of Class II usage in Order 1 have clearly increased in the past 10 years. Those cost increases are borne by the dairy farmers and their cooperatives in Order 1, and those costs must be reflected in the class price formulas.

The cost of farm to market hauling is one obvious element of the increased cost to supply Class I and II markets. The average charge to producers in the Northeast Farm Credit data from 1996 to 2006 has increased more than 60 percent from 54 cents to 87 cents per hundredweight. This number does not reflect the full cost of farm to plant hauling because some portion of those costs are underwritten by cooperatives in many cases.

The cost of farm to plant hauling has increased not only because of fuel costs, but also because of plant consolidations. These consolidations have allowed handlers to capture economies of scale, but lead to additional expense of their suppliers who have longer average farm to plant hauls.

All of the costs of organizational

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overhead associated with supplying the needs of our Class I and II customers have also increased in the last 10 years. In sum, supplying the Class I and II needs of the market costs more today than it did when the current Class I and II movers were formulated. As costs were recognized at that time, they should be recognized now through the adoption of Proposals 1 through 5.

We are well aware that changes in the Class I and II movers do not have the same impact on all produces and all regions. Regional impact differences occur with all, or nearly all, dairy programs. For instance, the MILC program has had a significantly greater regional impact in the upper midwest than in many other regions of the country. Likewise, the changes in make allowances will impact each order, and different producer groups, somewhat differently. But in each case, the MILC program and the make allowance changes, the policies are correct policies, in spite of differences in regional impact. The same applies to these proposals. They are proper

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and justified changes in the federal order price formulas and should not be stymied by regional interests.

Some may argue that there should not be any changes to Class I and II prices because there are over-order premiums in the marketplace which supposedly account for the costs of supplying the market. The truth is that with the current support price program and the minimum pricing philosophy of federal orders, premiums are no longer merely service charges as may have been the case several decades ago in some markets. In today's marketplace, premiums are a necessary part of the price of milk and will continue to be such. An increasing proportion of over-order premiums are being used to pay producers leaving even less to cover the costs.

The federal order reform decision and the National Milk Producers Federation testimony recognizes an element of market balancing in the Class I and II price formulas. It is critical that the record note two important qualifiers to balancing costs:

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First, not all costs of balancing markets are included in the basic price mover; second, not all market participants share equally in the costs of servicing the markets, although the balancing cost embedded in the mover is shared equally by all in the pool's blend price. That cost is an intrinsic part of the value of Class I and II milk and should be included in its price.

In doing so, the total order pool value is increased. Perhaps at some later time, market service payments can be considered so that the increased value can be more closely targeted to those who specifically provide services. In the meantime, at least that value is being captured and used to help dairy farmers.

For the same reasons that the make allowance hearing was considered an emergency and handled on an interim final decision basis, these costs affect the livelihood of producers. For example, more than -- and now it's 10 percent, more than 10 percent of Agri-Mark members have gone out of business in 2006

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alone. As we speak to these dairy farmers, almost all cite the cost-price squeeze as the reason. We submit that the record in this hearing of current farm level economics could not depict the need for expedited administrative procedures more clearly.

In conclusion, the ADCNE cooperatives, as the dominant suppliers to the largest Class I and II market in the federal order system, endorse Proposals 1 to 5 and the testimony of Roger Cryan for National Milk Producers Federation in support of those proposals.

We thank the secretary for holding this hearing and urge the promptest possible implementation of these proposals.

Q. Thank you. Now, Mr. Wellington, in recent years since the federal reform decision, has Agri-Mark experienced additional costs in Class I one markets such as related to homeland security that have not been previously in the system?

A. Yes. One example would be back roughly about two years ago, I think, there was

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an issue with a concern of homeland security about a pathogen that could be introduced to milk and would not be killed by the normal pasturization process. So they asked the processors to change -- I don't know whether it was a request or a mandate. Probably a mandate. That they change the pasturization process at both the temperature and the time, and in doing so, that would have killed the pathogen they were concerned about, but it also impacted bacterial counts that would affect the shelf-life of Class I milk.

So our customers came to us and said, you need to do something better on quality in terms of something called PI count, which I believe is a pre-incubation. So improve the quality of milk so our shelf-life gets better, and our response was, well, that's great, but we would like to get some money for that, and their response was, well, this is not something -- we're not getting any more money for it, we're meeting homeland security interests that have to be done, and you have an obligation to supply the Class I market to be

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in the federal order, this needs to be done. We had to agree that that was the case, and so our farmers had to change their quality standards, and in some cases, you know, had to add additional costs to do that, and there was no additional money that was presented to farmers or the cooperative.

In addition, the cooperative, if that PI count was a totally legal level but did not reach the level of the Class I processors, we would then have to take that milk and divert it elsewhere which would be transportation costs, might be the cost of the premiums for that milk. So those overall costs of the cooperative as well.

Q. So the cost of servicing the Class I market --

A. Yes. Exactly.

Q. -- has gone up?

A. One example.

Q. One example. Now, does Agri-Mark condense milk?

A. Yes, we do.

Q. Do you have any information with

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respect to its costs of condensing in -- well, do you have any information with respect to cost condensing?

A. Yes. I went to our senior vice president of manufacturing, Richard Langworthy who has also testified in federal order hearings, and he talked with his accounts initially to make sure they had the appropriate numbers, and they are within the range, the high end of the range, close to 7 cents a pound.

Q. With range which Dr. Cryan --

A. I'm sorry. The range of Dr. Cryan at its best.

Q. So Agri-Mark's experience then is consistent at the high end of things?

A. Yes, it is.

Q. Do you have anything you want to add before cross?

A. No.

MR. BESHORE: I have no further questions. Mr. Wellington is available for cross.

JUDGE PALMER: Let me just

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make sure I have received this statement. A couple others came in. We're receiving 26 which is Dr. Gould's, 27 which is Mr. Lee's and 28 which is Mr. Wellington's that we have received.

(Exhibit No. 26, 27 and 28 were received into evidence.)

JUDGE PALMER: Questions? No obligation here but -- Mr. Vetne.

CROSS-EXAMINATION

BY MR. VETNE:

Q. Mr. Wellington, on page 4 you comment on Class I and II premiums. You state premiums are no longer merely service charges as may have been the case several decades ago in some markets.

A. Right.

Q. Now, let's go backwards. The reference there to "some markets" implies a contrast with other markets. Is that contrast -- what is that contrast? Is it because premiums didn't exist or premiums were not merely service charges?

R. Wellington - Cross by Mr. Vetne

A. At various times premiums did not exist in markets. For example, in the northeast there were times in the 1990's where it was very difficult to get any kind of premium that was still service charges to service the market, but there weren't premiums on top of the service charges.

Q. So "some markets" referenced there was to some markets having premiums and some markets having --

A. Yes, plus I'm not familiar with all the markets, you know. I'm unclear whether it was all markets or not.

Q. And "may have been the case several decades ago", what characteristic of premiums does that refer to, the fact that there were premiums or the fact that they were designed as service charges?

A. Well, it's more of a case of several decades ago the farm price was much closer to the cost of production, and farmers could make a living at the market price. For example, the market price with milk several decades ago prior to 1980 were primarily based on the

R. Wellington - Cross by Mr. Vetne

support price of milk, and so that support price, most farmers could make a living and do well from that. They dramatically changed the support price in 1980 as most people know, and the market took over, and it created a lot more turmoil as such, and because of that, there was more pressure to try to get more money for farmers in the marketplace and more pressure to do more premiums and the like in the last several decades.

Q. But during that several decades ago period to which you referred, there were nevertheless costs of supplying the market?

A. Sure.

Q. And are you saying that that cost then was deducted from prices paid to producers rather than recovered in service charges or premiums?

A. Well, even back then, to my knowledge, we had service charges because there were different -- depending on the level of service that a customer would want, particularly a Class I customer, there would be different charges. I wasn't with the

R. Wellington - Cross by Mr. Vetne

cooperative at that point. So I'm not sure what those levels were, but even today, if a Class I customer wants milk five days a week and wants to have, you know, 10 loads on one day, on a peak day and five on others, you may have a higher service charge. If someone says I want five loads of milk seven days a week, and I don't think we have anybody on the Class I side that wants that steady of a pattern, but if they did, it would have to be less cost in service.

Q. I'm inquiring here about the temporal differences to which you allude in your testimony. So in the past there were still service charges directed to the cost of supplying food and milk?

A. Yes.

Q. In the markets with which you are familiar?

A. Yes.

Q. You are familiar with the fact that at least in your market and in some markets, other markets there have been no premiums?

A. I'm -- maybe I ought to clarify my

R. Wellington - Cross by Mr. Vetne

interpretation of the premiums and service charge.

Q. Please.

A. Okay. There's a total amount of charge that you charge a Class I customer for their milk, and part of that cost -- we break that cost down to service charge costs which can vary quite a bit depending on the level of service, and then there's premiums that basically are competitive-based premiums to try to make sure a supply of milk, and that generally stays the same or is very similarly on all the customers. So that's how I'm interpreting premiums versus service charges.

Q. I see. Okay. So there's a portion that's not service that's nevertheless recovered, and part of that is your ability to charge -- you charge as much premium as the market will bear?

A. That's right. You always try to do that. You always try to raise that level. Unfortunately because of our marketplace, there's still a fair amount of independent who produce milk and independent processors, and

R. Wellington - Cross by Mr. Vetne

there's alternatives our customers can get in terms of milk from other sources other than Agri-Mark, our ADCNE coops.

Q. In your last sentence in that same paragraph you say, an increasing proportion of over-order premiums are used to pay producers leaving even less to cover the costs, right?

A. Right.

Q. Your use of the term premium in that sentence includes the aggregate of service charges and premiums that you could charge above it?

A. Yes. That's true. When I'm talking about the overall total piece, that's really of both, and the reason behind that is that as farmers are struggling more and more and as more pressure on them on the cost-squeeze side, the independent processors are more likely to get -- you know, take our members away from us. So we're looking at that and saying, okay, we have to get more milk, more money to keep that there, and there's less actually to cover the costs at the end of the day for the cooperative.

R. Wellington - Cross by Mr. Vetne

Q. Is there less to recover costs if that happens if the total over-order amount charged is static?

A. Yes.

Q. And Dr. Cryan testified to a general pattern of increasing over-order charges. Does that pattern reflect your experience in the northeast?

A. It does, but normally it's almost like a step process, that -- for example, our charges have been about the same for, gosh, over two years, and then if something happens in the marketplace, we can move prices and try to capture more of it. Let's say, for example, if the class price were to fall dramatically, and so Class I customers have a less total cost for their milk, that might be a better time for us to try to achieve some of these costs than if the Class I price under the federal orders is rising, and then they are already occurring higher costs in that degree.

So it's not a straight pattern that we are increasing every month or every year. We look for opportunities in the marketplace.

R. Wellington - Cross by Mr. Vetne

We have to see what our competitors are doing, and then we take action that we can agree upon with our customers.

Q. When you use the term in that same sentence, increasing proportion, the word proportion, do you mean it in its logical sense as percentage of the total premium?

A. Yes. That's really what it is.

Q. So even though the total over-order charges go up, an increasing portion of that increasing over-order charge is going to producers rather than to cover the service costs?

A. Yes, that is true.

Q. And is there any documentation which would show the trend of that proportion in bulk order charges?

A. I have none with me, no.

Q. None with you. Are you speaking only from your experience in over-order charges for which you have responsibility?

A. Well, I'm speaking for the information that I'm aware of that Agri-Mark charges.

R. Wellington - Cross by Mr. Vetne

Q. Yes.

A. I don't necessarily have responsibility for setting these. My boss would do that.

Q. You have responsibility for tracking Agri-Mark's over-order charges, being aware of them?

A. Certainly be aware of them. I'll put it that way.

Q. And I infer that you have no specific data from other suppliers on the relationship of the proportion of over-order charges paid to producers or paid to recover increasing service costs?

A. No, I don't have anything of that nature.

Q. On the last page you refer to loss of some members in 2006 -- or actually producers that have gone out of business?

A. Yes.

Q. Which is not the same thing as change in business, members?

A. That's true. In fact, this is specifically farmers who have sold their cows

R. Wellington - Cross by Mr. Vetne

and are no longer shipping milk to anybody.

Q. Okay. So it's not necessarily indicative of membership?

A. True.

Q. Farmers selling their cows, first of all, the cows usually go to other farmers; is that right?

A. For the most part, yes.

Q. For the most part?

A. Not all the cows, but usually for the most part.

Q. Unless they are towards the end of their productive cycle in which they go to McDonald's?

A. Correct. Or Burger King.

Q. And farmers selling their cows and going out of business is something that has been around for decades?

A. Yes, it has, but it's much more in a -- you could not imagine if we would be losing over 10 percent of our membership every year and be around very long.

Q. Have you compared the rate in this stress cycle with the rate in prior stress cycles?

A. No, but I can say there's never been a time that we have lost as many producers, an either absolute amount or a percentage that we have lost over the last 11 months. In fact, that's why originally I had five percent because I was thinking about the pattern we saw. I don't track these numbers every month. I call my office, and I ask our membership department, can you tell me exactly how many. That's when they said 162. I had to take a step back. So this is a much faster rate.

Q. The producers in 2006 that decided to quit producing, do you have any information on the age of those producers or how that related to their plans to retire?

A. No, other than from the ones I talked to and from talking with our field services, I have talked with, of course, all of them, they tend now to actually be younger than as seen in the past. Usually the attrition pattern is because age is a big factor or the second generation is not available or economic stress is such, but this time around they tend

R. Wellington - Cross by Mr. Vetne

to be a higher percentage of larger farms, farms in the milking industry have 200, 300 cows, and that wasn't the average size, of course, but in the past, pretty much all the farms that went out of business were milking less than 100 cows, 50, 60 cows. They were small. They might have gone out for health reasons, a lot of factors.

This time around pretty much everybody that I spoke to and also the field staff spoke to talked to the price of milk and whether they would stay in business. Our biggest single month, John, and this may be helpful to you, I hope, our single biggest month was April and September. We lost over 25 members in both those months, and I think that's indicative of farmers saying in April, should I stay around to plant my crops and be there, and in September it's indicative of how were my crops and do I have enough feed to last through the year.

I think it really has to do with both the crop pattern and the price of milk, because you could get over bad crops with a

R. Wellington - Cross by Mr. Vetne

good price of milk because of purchase.

Q. Have you consulted with members or are you aware of anybody in the organization that consults with members concerning production, termination decisions, decisions to --

A. Oh. Our field staff -- whenever somebody gets a termination notice, our field staff always visits them and tries to ask the reason why, where their cows are going because we do report that to our board of directors every month.

Q. Is anybody in your organization and field work involved in planning that process for dairy farmers?

A. Oh, no. No, not at all. Not that I'm aware of at least. I imagine some people do some work on the side, but I don't think that's the case.

Q. Are you aware of whether producers that are planning to quit dairying do plan in advance for that kind of thing?

A. I would hope. It's a very important business and lifestyle decision. I hope they do that. I think part of their planning is, you know, what they could do in terms of feed and other factors. So whether they decide to do it in a few months or whether they say, okay, I'm out of business as of next week, I'm not sure how much time they take.

Q. Have you observed in the past that producers who have made a decision in the near future to stop dairying will continue dairying longer when prices are good and continuing dairying a shorter time when prices are in decline?

A. That's usually a pattern -- a commonsense pattern. I have seen that, yes.

Q. And during the 2006 period to which you referred here, your members were burdened by charges resulting from an inadequate make allowance in the system?

A. Yes, they were.

Q. And that burden was for your members and for some other in the northeast that didn't manufacture?

A. Everyone, I believe, felt a burden in different ways, but I think ours was

R. Wellington - Cross by Mr. Vetne

probably greater than some others because of our high proportion of milk volume.

Q. Do you know whether the relief to -- a partial relief to Agri-Mark and its constituent members from the tentative final decision on make allowance would have been sufficient for some of these producers not to go out of business?

A. I think it would have helped because it was very discouraging as we looked forward, in April, for example, to look forward into the year. At that point we knew that, for example -- well, we knew the make allowance, I assume, before the end of 2006 at that point. So -- could you repeat the question?

Q. Yes. Whether the fact that a remedy on the make allowance problem was not in place during 2006 and the fact that you were charging some of those costs?

A. Yes. And that's somewhat affected those, but members also had an option, and that is to leave the cooperative and not have to incur those costs. You know, most of our members have a year contract, and some have a

R. Wellington - Cross by Mr. Gulden

month contract. Those that went out of business, I don't think they went out for that specific business. I mean, I think it was part of the package, but I think it was the whole general price level that they were facing.

Q. That whole combination of factors of revenue and costs?

A. Exactly.

Q. I mean that's what it is for everybody?

A. Yes.

MR. VETNE: Thank you.

JUDGE PALMER: Yes, sir.

MR. GULDEN: My name is Neil Gulden for Associated Milk Producers.

CROSS-EXAMINATION

BY MR. GULDEN:

Q. Bob, just a couple quick questions. First of all, do you have any reason to believe that farm costs of production, cost of production issues that you talked about in your testimony are necessarily any less in low utilization markets than high utilization

R. Wellington - Cross by Mr. Gulden

markets?

A. Well, it depends on which cost you are talking about. If you are talking about just on the farming of producing the milk, I would say comparative farm, no. If you are talking then about cost that farmers get for servicing the market, for example, hauling costs that farmers pay a portion of when the milk is traveling 150, 200 miles to a Class I market or balancing issues and things like that, I think there are higher costs that get reflected back on with their cooperative, but not the cost of producing the milk, other than -- my opinion on that is in the Class I -- higher Class I market, you basically have to be Grade A, you have to be Grade A. There's a maintenance cost to be maintaining Grade A.

In a low utilization market, if you so choose, I guess maybe you don't have to be Grade A, and there might be a different cost structure there.

Q. You realize that in low utilization markets there's milk that moves 150 miles, 200 miles also that has higher transportation

R. Wellington - Cross by Mr. Gulden

costs?

A. I'm not sure. I thought all your farms were around -- no. That may happen. I'm just saying that in our market, okay, the great bulk of the farms are out in the countryside, and they tend to be closer to manufacturing plants, cheese plants, for example, than they tend to be close to other areas, New York City and the like.

Q. In general, do you believe that farms in low utilization markets need a price increase any less that farms in a higher utilization market?

A. I think right now all farms need the price increase no matter where they are at, but I think this issue is not just about arbitrarily increasing the price. The issue, as I understand, is that there's a cost that people at -- that the Class I market -- let me rephrase that. There's a cost that is incurred by supplying the Class I market, and we try to reflect that cost, and those costs are more than more of the Class I market you provide. So we're just trying to recover that cost.

R. Wellington - Cross by Mr. Rosenbaum

It's not saying, gee, let's arbitrarily give every farmer a dollar, the MILC program or something. This is trying to relate to costs that farmers have incurred or at least their cooperative.

MR. GULDEN: That's all I have, Your Honor.

JUDGE PALMER: Very well. Other questions?

MR. ROSENBAUM: Steve Rosenbaum for International Dairy Foods Association.

CROSS-EXAMINATION

BY MR. ROSENBAUM:

Q. Mr. Wellington, has your organization tentatively announced an increase in your over-order premiums effective January 1?

A. There's been some over -- in the over-order premium, there has been -- it's entirely related to RBST-free milk. That's the only premium that has arisen in my organization over the last few months and has to do with

R. Wellington - Cross by Mr. Rosenbaum

providing RBST-free milk compared to buying milk that is not certified as RBST-free.

Q. Have others in New England announced over-order premium increases that extend beyond RBST-free milk?

A. Not that I'm aware of.

Q. What's the size of the increased over-order premium --

A. For RBST-free milk?

Q. Yes.

A. 40 cents. It's going to go up in January though.

JUDGE PALMER: That's per hundredweight?

THE WITNESS: Yes.

Q. Sorry. 40 cents is already in place or --

A. 40 cents was in place, I believe, as October 1.

Q. What's going up in January?

A. For RBST-free milk, hopefully we'll go up to 75 cents.

Q. But it did not apply to other milk; is that what you're saying?

R. Wellington - Cross by Mr. Tosi

A. It does not apply to standard milk that's not certified. RBST-free meeting all the standards that all the states seem to have these days.

JUDGE PALMER: Yes. Mr. Tosi.

CROSS-EXAMINATION

BY MR. TOSI:

Q. Good afternoon, Bob.

A. Good afternoon, Gino.

Q. What is it about accurately reflecting these additional cost increases that dairy farmers incur supplying the fluid market that makes it so urgent that it be reflected in our minimum prices when there are over-order premiums?

A. Okay. Because the over-order premiums that are out there do not cover all the cost of doing this. We'd like them to cover them, just unable to do so. And so if we could cover these costs to the federal order, that money would be passed back to the producers through the pool. It may be a

R. Wellington - Cross by Mr. Tosi

situation where their coop, for example, has to subsidize this, which means if we subsidize it, it means less returns to our members, but at least they'll be getting that money through the federal order pool.

Q. To the extent that Class I, II, III and IV prices are based on a formula, if the prices in the context of the cost components are not in the proper relationship, what implications would this have on orderly marketing, the orderly exchange of milk from dairy farm to processor?

A. Well, there's an advantage to a particular class of milk. If it's a lower price relative to what you could get for the product, then more milk would flow into that. Let's say it was that Class III price. Okay. Let's say that the Department were to give a Class III make allowance arbitrarily that's twice what the amount was. Okay. And then suddenly a cheese manufacturer says, well, gee, I can make cheese for that, I'll outbeat everybody else with Class I. So it is important that the prices be aligned. We all

R. Wellington - Cross by Mr. Tosi

recognize that, or else you are not going to be able to attract milk to the proper classes of milk, particularly the most important class of milk, in our opinion, for the federal order is the Class I price.

Q. In the context of minimum prices, our minimum regulated prices versus the actual price which -- let me just propose to you that actual price is the minimum plus whatever price that you are able to negotiate above the minimum.

A. Yes.

Q. How much of that competitive ability here to negotiate should be reflected in either the level of the Class I differential or in how you would adjust the Class I pricing?

A. Well, it's always easier to -- I mean I would love to say 100 percent because it's always easier to get it when it's a regulated price, but, you know, if it can't be, I would say as much as possible certainly reflect these increases in costs, and that's really what we're trying to do on this is to increase any increases in cost that have

R. Wellington - Cross by Mr. Tosi

incurred over time, and whatever percentage that is existing, we wouldn't want to lose on that percentage. In other words, when you have a static number and the costs have gone up, you are now recovering a smaller proportion of the cost. So at least let us cover that same proportion.

Q. Could you please expand a little bit more on the nature of the emergency. In your testimony, you do cite a cost-price squeeze as a reason.

A. Right.

Q. But in the context of what makes it an emergency with respect to what the proposal is asking to do?

A. Okay. Our goal here is to try to get farmers as much money as possible in these times of low prices, and so it's readily important that -- in fact -- I'm sorry. Low prices and high costs. It's vitally important to try to get every penny we can to cover those costs and get that back into dairy farmers' hands, and they are particularly being impacted by a couple different factors, and one of which

R. Wellington - Cross by Mr. Tosi

is the make allowance on III to IV which, you know, as one of the proponents of that, you know, we clearly felt that that was justified to make sure that we have markets available for milk because not only do the farmers need a good price in the market, and so we needed to do that, but the bottom line on that, that that will lower farm prices at least initially on a static basis when it was first put into effect.

So if dairy farmers have to recognize those higher costs that manufacturers have in order to keep that market, we think it's only fair that dairy farmers yet recognize their higher cost to help off-set true costs that are incurring and raise their income even marginally, and also, I think it sends the right message to dairy farmers.

The biggest problem we had when I tried to explain the make allowance to both Agri-Mark members and others was that they understood that cost of manufacturers went up, and I explained the circularity of the math price and what have you. They all understood that, but they said, you know, you are saying

R. Wellington - Cross by Mr. Tosi

that they should be able to cover their costs, but no one is telling me I'm allowed to cover my costs, and I say, well, the marketplace does react to that, that's why in 2004 you probably did cover your cost. Okay. But they are saying, on the regulated side how do we do that, and so that's why I think a lot of discussions occurred with National Milk, and Dr. Cryan said, how do we do that, how do you arrange that on a regulated basis we cover it, and, hence, this proposal came up.

Q. It's clear that your position is in support of the National Milk proposal. But with respect to the three separate components, you know, one being the competitive factor, Grade A maintenance and the transportation?

A. Yeah.

Q. In your statement here, you do point to the Northeast Farm Credit Data?

A. Yes.

Q. It shows about a 60 percent increase?

A. Yes.

Q. Does this track with what you know

R. Wellington - Cross by Mr. Tosi

about the additional hauling costs that your members are incurring?

A. It tracks fairly well with what we're charging our members. Okay. It doesn't track as well, for example, what the true costs are, because one of things that Agri-Mark has is -- and in addition to charging members a cost of -- a hauling cost relative to where the farm is located and where the markets for their milk are located, we have a transportation pool that is -- it's like five cents per hundredweight or something that everybody pays. It is straight five cents per hundredweight to help move milk around, and that occurs when changes occur in the marketplace, and often it's on the Class I side that are no fault of the producer and probably should be lowered individually.

I'll give you an example because it's kind of an interesting one. The HP Hood Company had a very large plant located immediately outside of Boston. You can still see the chimney stack. It's like 100 feet tall or taller. They closed that plant 15 years ago

R. Wellington - Cross by Mr. Tosi

or over 15 years ago. And now a lot of that milk is packaged out of Massachusetts which West Springfield and center part of the state, and we have producers located between Boston and West Springfield, and their milk used to go to the Boston market. Now their milk goes backwards. If you were halfway located between the two areas, you have about the same transportation costs, but under the federal order, the price is 25 cents difference between the two, and so we could have said to that farmer, well, now you are going to get 25 cents less. That was of no fault to the farmer. That was a decision that the Hood Company made. I'm sure it was a good decision for them. So we pay that farmer the same base, but that additional cost of doing that and the lower value comes out of a pool within the whole cooperative.

MR. TOSI: That's all I have. I appreciate your patience. Thank you.

JUDGE PALMER: More questions? Mr. Yale.

MR. YALE: Benjamin Yale on

R. Wellington - Cross by Mr. Yale

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

CROSS-EXAMINATION

BY MR. YALE:

Q. Bob, this question comes -- I mean I'm asking questions to try to determine where to go. One of those is, as I listened to you here today, are you saying that the costs of a farmer to produce milk is irrelevant in establishing the Class III and IV prices?

A. The important part of establishing the Class III and IV price, in my mind, what they can get for the III and IV products, the price of the products, what the yield factors are, as I'm sure you know, and also what the cost of making the product. On the farm side if you incorporate the cost of production on that, you have no way to balance the markets. If you try to save the price you pay farmers, their cost of production, there's no way to clear the market if the marketplace won't support that price of milk. That's where the problem is. So I would have to say it's

R. Wellington - Cross by Mr. Yale

unfortunately, but the answer to your question was yes, if I remembered your question right.

Q. Now, I appreciate that. That answers that question. The next question comes in that there has been testimony by a number of people, I think even to a degree yourself, in terms of the markets have found ways to adjust to some of these changing needs or demands for Class I in terms of moving the milk, getting the milk to the plants, maybe less effective in the northeast as it is in the southeast or other parts, but the market has added over-order premiums. There's some give-up charges and other things that have been worked in there.

As it stands now, the money that is paid in an over-order premium only is distributed to those cooperatives or producers who are delivering the milk to the bottling plants at that time, right?

A. Yes.

Q. Now, the costs that you talk about and that Dr. Cryan and others have talked about are the costs that are directly related to

R. Wellington - Cross by Mr. Yale

providing milk to the Class I market, right?

A. The direct cost, yes. Okay. But there are other costs, for example, that producers would bear that a lot of them aren't even aware.

For example, Class I processors who have independent supplies are often balanced by dropping producers if they have too much milk. That's a huge cost to a producer when somebody gets notice that he's been dropped.

Q. That's one of the advantages of the cooperative is to protect them?

A. Right. Right.

Q. But my question comes back that -- based on your testimony, you talked about how the need to be Grade A and some of the others, it's not -- the quality is not nearly as relevant in the cheese as it is in bottling. The cost to maintain Grade A status that we're talking about here is to supply the fluid market, right? That's what it's necessary for?

A. Yes.

Q. The fluid market?

A. Yes.

R. Wellington - Cross by Mr. Yale

Q. And the transportation, the extra transportation costs that we're talking about that producers bear is related to supplying that milk to the fluid market, the cost to move the milk from the farm to the fluid market?

A. That's what we're most concerned about at this hearing, yes.

Q. And the other part of this is is that the cost of balancing, as you have mentioned, that is either moving milk in another direction or taking a hit on the price or whatever so there's always the supply of milk to meet the full needs of the Class I is for the fluid market, right?

A. Yes.

Q. All right. So if you take that and that that is truly an extra cost, and I don't think anybody can argue that it costs less today to move milk than it did 10 years ago, it clearly is more, but if that's what the cost is, your proposal that you are supporting here appears to me and to others is that it's not giving money to those supplying the Class I market, by moving it into the regulated, we're

R. Wellington - Cross by Mr. Yale

giving money to everybody else, and, therefore, the Class I market needs 77 cents, it's not going to get 77 cents for its Grade A, right, but it's going to get 70 cents times its Class I utilization?

A. No. I think what we're trying to do is recognizing that there is this cost, and we're trying to retrieve that cost on behalf of dairy farmers. I would agree that if we could do this hearing to increase it by 77 cents and at the same time do market service payments to allocate some of that money to those people who are specifically providing it or running balancing plants like ours, for example, are running it 15 percent in capacity right now, that's a high cost. We can do that. That would be very nice, but that's not the purpose here. We're basically looking at trying to capture the cost, and I imagine that at some point in the near time, we might submit a proposal for market service payments saying we are functioning with those things.

Q. Have you done any analysis or do you have an opinion as to whether or not your over-

R. Wellington - Cross by Mr. Yale

order premiums will absorb some or all of this additional Class I price?

A. I believe that it will. Okay. And the reason I do is because when I look at the Class I price changes that have occurred, and I look at -- let's say, for example, I'm using the Northeast federal order price at Boston. From February to April of 2006 the Class I price dropped $2.00, over $2.00, but our premium stayed the same. Then from September through November the price increased over a $1.50. Our premium stayed the same.

So I mean we're talking about the normal federal order price was around a lot, and it doesn't necessarily have to affect our premiums. That's not to say our customers may come to us and say, hey, guys, there's 77 cents here, we would like to get some of that back, and that's not to say that we might be in a position where we have to give some of it back, particularly prices are rising dramatically, and what we might say to a customer, for example, is, okay, farmers need this money, but we see that prices are going up a couple bucks,

R. Wellington - Cross by Mr. Vetne

maybe we can give you a credit now, but when the prices fall, we want to get it back because that's when the prices are falling, it might be easier for you to pass it along. We have those discussions on a regular basis to make it easy for everybody, but I would say for the most part, federal order prices are much easier to get from our customers than over-order prices with any kind of changes or increases.

Q. Let me follow up with this as a final question. By adding additional monies in the Class I price as opposed to the over-order, are you creating a greater incentive for the independent supplying to those plants as opposed to a cooperative?

A. I'm not sure, Ben. I would have to think about that. If we just left it alone like this, and we're taking dedicated costs that we're incurring and giving it to everybody, that is an issue without a doubt, but right now the most important issue is to get a recognition of the cost and money into the farmers' hands and then follow it up hopefully with something like market service

R. Wellington - Cross by Mr. Vetne

that would impact the farmers. So that is a risk we're taking, but in terms of what farmers need in costs is a risk that my coop and the ADCNE coops are willing to make right now.

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

JUDGE PALMER: Questions? Mr. Vetne.

CROSS-EXAMINATION

BY MR. VETNE:

Q. I just have one question. You referred in response to Mr. Tosi to a five cents transportation pool. Is that outside the federal order system?

A. That's totally, John, within Agri-Mark.

Q. Oh. Within Agri-Mark?

A. That's totally within Agri-Mark. For example, if we sum up our transportation costs that we have to pay within our own system and then we sum up what the deduction we take for members, okay, and then we say, okay, is there some other way to get some of that money

R. Wellington - Cross by Mr. Vetne

back, because we don't cover all those costs. So we look at it, and we have a hauling committee, they look at these numbers and say, okay, we'll go with a general amount like five cents that we charge to all members. Even that doesn't cover all the expenses, but it helps cover a part of them on it.

Q. So all Agri-Mark members contribute a nickel to the transportation pool, and then Agri-Mark uses that to off-set unusually high costs of transportation?

A. Right, John, because there are times when the plant needs change, and you are moving milk elsewhere, but it's not to the fault of the farmer. So you can't say to that farmer, you know, hey, your transportation costs went up 25 cents because somebody doesn't want your milk today or this month or whatever. So we continue to charge them what we have been charging them, and that's an issue for the coop on routing milk and dealing with our customers.

Q. Does Agri-Mark have any symbol or transportation sharing -- cost-sharing arrangement with any other milk supplier.

R. Wellington - Cross by Mr. Vetne

A. I don't believe so. I don't know, but I couldn't say for sure.

Q. Are you aware of any other arrangements, similar arrangements operated by other suppliers within their system or systems?

A. I'm not sure of that. I will say that -- maybe this is going to your question and maybe it's not. I mean we comingle milk with other cooperatives, for example, such as DMS in their marketing. We try to keep the farm hauling cost as low as possible. So we do do that. I don't know if that's what you were asking about, but we definitely do that.

Q. An Agri-Mark truck will pick up a DMS farmer if that's a more efficient haul, or they might pick up one of your farmers if that's more efficient to a common destination?

A. Yes. We try to work together and lower our cost of all our membership.

MR. VETNE: Thank you.

R. Wellington - by Judge Palmer

EXAMINATION

BY JUDGE PALMER:

Q. I'm going to venture into -- rather I just thought the record might be helped if we understood how class prices do work. So if you don't mind, feel comfortable about just giving us some of these formulas.

A. Formulas?

Q. Well, not so much. Class IV is the lowest price?

A. Yes. Class IV is the lowest price, and it's based upon the price of butter and nonfat dry milk powder.

Q. Class III?

A. That's a price -- well, I can't always say that Class IV is the lowest price. Normally it's the lower price. Class III is based on the price of cheese, and it's basically cheddar cheese block and barrel cheese and the price of dry whey.

Q. Now we get to Class II.

A. Class II deals with soft, I would call them, semi-perishable dairy products such

R. Wellington - by Judge Palmer

as cream, cottage cheese, yogurt and ice cream.

Q. Class I is?

A. Class I is basically drinking milk.

Q. But what I really want is a little bit about those formulas. How do you set the Class IV price?

A. The Class IV price is actually one of the simpler prices. Don't ask me to pull out all the numbers. You basically look at a survey price that's paid on average every month that USDA calculates through their National Agriculture Service. So they calculate what the average price is. They justify the yield of the product, and then they subject the make allowance currently in the order.

Q. Then you subtract make allowances?

A. Right. So between those three pieces, the price, the yield and the make allowance, you end up with a price.

Q. What's the Class III?

A. Basically the same thing. It's a bit more complicated. It could be simple in terms of doing the same thing, looking at the cheese price, the yield and the make allowance

R. Wellington - by Judge Palmer

and the same thing for whey, except because the federal orders use the butter fat price that's used for Class IV, they apply it to Class III, but it has a different value in cheese. So it's a much more complex formula.

Q. That's done by a formula?

A. That's all detailed formulas that are there.

Q. Now, Class II looks to which of those prices?

A. Class II is tied directly to the Class IV price, and it's essentially the Class IV price plus 70 cents. Now, you can't look at the announcements and just add 70 cents to the Class IV because they do have advanced pricing on classes relatively for it.

Q. Class I?

A. Class I looks at the higher of the Class III or the Class IV price. Now, the last couple years that's been the Class III cheese price. This year, and I would say probably by February, I believe that the Class IV price will be higher due to the tremendous amount of demand for nonfat dry milk on the market, but

R. Wellington - by Judge Palmer

USDA looks at both Class III and IV, what's the higher, and then they add the Class I differential that exists in the different areas of the country. There's a very detailed -- in Boston it's $3.25.

Q. Plus a certain amount which varies in the order?

A. Yes. And that's usually referred to as the Class I differential.

Q. The make allowances, are they reflected at all in the Class I or Class II price by relationship?

A. Currently only to the extent that they affect the Class III and Class IV price. Since the Class I and II are built on top of the III and IV, if the make allowance moves to III or IV, it then moves to Class I and II.

Q. What I'm trying to get to, would not then the change that's being made from the prior hearing, the make allowances already be reflected in some way or will be reflected in Class I and Class II without your proposal?

A. It will, but the net effect will be that it will lower the Class I price at a time

R. Wellington - by Judge Palmer

when farmers are paying more to cover the cost of serving the Class I market.

Q. I see. So in other words, your Class IV prices, whatever that formula is, less a certain amount?

A. Yes.

Q. Plus a certain -- what is it?

A. The Class IV price is less the make allowance.

Q. Less the make allowance?

A. Right. So as we increase the make allowance, they lower the Class IV or the Class III price. So as we lower those prices, the Class I price will move down with it under the current situation. We're trying to compensate farmers for the fact that, gosh, there's other costs besides the make allowance on manufacturing that relate to the Class I side that we're trying to venture.

JUDGE PALMER: I thought it would be helpful to have that in one place. Who else has questions? Mr. Beshore.

MR. BESHORE: Some redirect.

JUDGE PALMER: Is there any

other cross before Mr. Beshore undertakes redirect? There don't appear to be any. Go ahead, sir.

MR. BESHORE: Thank you. Just a couple of questions.

REDIRECT EXAMINATION

BY MR. BESHORE:

Q. Bob, you referred probably in response to John Vetne, I'm not sure, to one question that Agri-Mark having a high proportion of milk going to manufacturing or something?

A. Higher proportion in the marketplace.

Q. Just so the record is clear --

A. Sure.

Q. -- roughly what's Agri-Mark's utilization fluid supply? I mean are you a major fluid supplier?

A. Oh, we are a major fluid supplier, yes. Right now I would say the majority of the milk, over 50 percent of our milk is going to Class I processors. That's why, for example, I

R. Wellington - Redirect by Mr. Beshore

mentioned in my testimony that the class -- the utilization -- the capacity utilization at our West Springfield butter powder plant is less than 15 percent right now. It's basically taking milk in on weekends because we're free in Class I. In addition, our cheese plants are operating only five or six days a week. At a time we might like to operate seven, but we're freeing up additional milk.

When I said that we have a higher proportion, right now the federal order has approximately 22 to 23 percent of its milk going into the Class III cheese plants.

Q. That's Order 1?

A. That's Order 1. We're probably more likely over about a third maybe of our total volume of milk end up in cheese plants of our own or cheese plants that we also send milk to.

Q. Just so there's no question, the percentage utilization at West Springfield presently, it's not less than 50, it's less than 15?

A. 15. If I misspoke, it's 15 percent.

Q. I'm not sure you misspoke. I want

R. Wellington - Redirect by Mr. Beshore

to make sure there's no question in the record.

A. You're basically equivalent of receiving milk one day a week. Most likely it's on a Saturday or something because I mean that's when the Class I bottlers basically have all their milk in place for the weekend. So the milk has to go somewhere. It goes there.

Now, that percentage will change dramatically somewhere around December 23, 24 when all the milk is in the marketplace, all those plants close down, and we will suddenly reach the 100 percent utilization probably for several days.

Q. Okay. You were asked a few questions by, perhaps, Mr. Gulden with respect to disproportionate regional impact of the proposals or with respect to whether costs are different in one region or another. Now, has Agri-Mark supported the MILC program?

A. Yes. And, in fact, we developed the MILC program with Senator Lehey and other legislators. It's not a coincidence that the MILC national program uses a price of 1694 in Boston to create the pricing level. That was

R. Wellington - Redirect by Mr. Beshore

done because that was a dairy compact price that we had established. It's not a coincidence that initially it was 45 percent Class I utilization across the country. So, yes, we are intimately familiar with that.

Q. Now, could you just describe a little bit the regional impact of that program, northeast versus upper midwest, southeast versus upper midwest?

A. Certainly. Normally on a program that paid all producers the same rate per hundredweight, there wouldn't be much of a regional, the farms would be the same, but this program has a 2.4 million pound cap, and the reason the fact the cap exists at that level is because of a legislator, Peterson, a congressman from the upper midwest at the end who bargained that down to 2.4 million. We had proposed 8 million as an example, but because of that low rate, then it pays more to smaller farms or at least pays on a year-round basis. Anyone who produces less than 2.4 million pounds, and milk is roughly 200 pounds less -- or I'm sorry -- about 120 pounds less. That's

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a full payment all year long. Those that are milking more have to choose when they start their payment. Of course, they don't get it for the entire year.

So farms like out west that are milking several thousand cows, I mean one farmer I spoke to out west said that he goes through his MILC payment in 36 hours or something, a phenomenally short period of time because he produces 2.4 million pounds in 36 hours, and so they get a much lower rate per hundredweight across their hundredweight milk production.

The highest payment rates, to my knowledge, are in the upper midwest as a region. They might be higher, a little higher on a rate -- I think we had members in Rhode Island who may have the highest because I don't think there's a farm left in Rhode Island that we see 2.4 million pounds. So there's 17 farms left, and they probably get the best. We felt that our guys get a higher percent in Rhode Island, but they get the highest percentage of it, and larger farms get -- we get a smaller

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percentage than the upper midwest, although we still get a fairly good percentage. Larger areas get less, but when we supported the program at every stage including reenactment, we did not look and this and say, gee, they are getting more than us, we need to change this program. We thought it was a desperately needed program for all farmers.

Q. In spite of the fact that it would advantage others more than you?

A. Right. And we could have made the argument, well, jeepers, doesn't this increase milk production in the upper midwest more than anywhere else because they get a higher amount, and given all the models they talked about today, I guess you could certainly make that argument.

We also look at it and say the MILC program only triggers in when prices are low to farmers, and I would respectfully disagree that if a farmer is losing $2.00 per hundredweight and we have a program and we give him a dollar per hundredweight, I don't think that farmer is going to run around and put on more milk

R. Wellington - Redirect by Mr. Beshore

production so he can go back to losing $2.00 again. That's not the way the system works. In fact, often when the price is increased when they are losing money, they might even produce less milk when that happens because they can off-set some of their cashflow needs.

The first thing that happens when milk prices fall is that every business has to look at its operating cost and say, how do I increase my revenue, and one way to do that is to produce more milk. It really puts farmers between a rock and a hard place, Catch 22 I guess you could call it when that happens.

So I don't necessarily agree, and I know this will probably bring a lot of questions, but instinctively you know that you are going to increase milk production. You may keep more farms in business, and if you do that in a Class I market that can use the milk such as the southeast or we're getting more and more to the northeast, the northeast in the month of October had 73 percent Class I, Class II utilization. 73 percent. That's incredible. We're about 52 percent Class I. And with

R. Wellington - Redirect by Mr. Beshore

balancing that needs to be occurred on a seasonal basis, on a weekly basis, you know, gosh, I mean, we're starting to approach the southeast it seems in my mind.

Q. Let me shift gears just a little bit. Ben Yale asked you a question, and you had to think about it a little bit. I want to try to pose it another way and see what your reaction is.

A. Did I think wrong on it?

Q. Not at all. But I want to see if you think a little more. If we have a 77 cent cost increase for supply Class I markets, let's say, which is a more difficult competitive environment for cooperative supplying in Class I versus potential independent competition, if the 77 cents is added on to an over-order premium so they could get it out of the market in an over-order premium, so that if you have got $2.00 in over-order premiums, you've got $2.77 or if it's 77 cents is added into the regulated minimum price that all plants must pay?

A. It's much more difficult if we have

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to do it in the marketplace. In fact, I would say to you, Marv, it's impossible because we have these costs -- I would love to go, for example, $2.77, but on behalf of our members we would be unable to do so, but if we can do it through the federal order system, there may be some repercussions, but I don't think so because the federal order prices move so dramatically lately that sort of everything gets lost in the shuffle of these price limits.

Q. And one final question. Dr. Cryan in his testimony talked about the fact that one of the additional costs of servicing the Class I markets in recent years has come with plant consolidations which generate efficiencies for the processors. Do you recall his testimony along those lines?

A. Yes.

Q. Is the Hood example, the closure of the plant near Boston and the use of the Agri-Mark facility, is that an example of fluid plant consolidation?

A. That's a tough example in that case. I would certainly say would be the case, for

R. Wellington - Redirect by Mr. Beshore

example, with Dean Foods with Correlli Farms in Franklin, Massachusetts. They closed a large number of smaller plants, gosh, five or six of them. With Hood it was a little different situation. Actually the larger plant was in Boston, but it was very costly to operate, I guess, because of labor costs and other factors.

So they found it more cost-effective. Efficient may not be the right word, but certainly more cost-effective to close that plant to the benefit of the owners of the company and then relocate elsewhere. So my only question would be on efficiency. I'm not sure if Hood was efficiency or it was the total cost involved.

Q. In any event, it -- well, the Dean example --

A. It was a benefit to Class I processors.

Q. At the same time there was a cost to the suppliers?

A. Yes.

Q. Either in reduced class price at the

R. Wellington - Redirect by Mr. Beshore

plant or in additional hauling costs?

A. Yes.

MR. BESHORE: Thank you.

JUDGE PALMER: Any more questions?

A. If I could have one more in response. We're told by our Class 1 processors, and I'm sure there's going to be some testifying, so they can either verify or dispute it, but that when they go to their customers, retailers, for example, the retailers are intimately aware of federal order price announcements that the market administrator puts out. So they see that price, and they understand when prices move with that price, but if one of our customers has to go and say, well, the marketplace moved it up, that was very difficult.

So the retailing side understands the federal orders more than they do in the marketplace. At least that's what I'm told.

JUDGE PALMER: Any other questions? Sir, you are excused. Thank you very much. Who are we going to call as our next witness? Do we have someone in mind?

MR. VETNE: Are we all done with proponents?

MR. BESHORE: I don't have any others.

JUDGE PALMER: He has no others.

MR. VETNE: We have one more proponent-supporting witness.

JUDGE PALMER: This is a proponent's witness. All right. Sir, come forward. We're going to mark this as 29. We'll mark the statement as 29.

(Exhibit No. 29 was marked for identification.)

EDWARD CROSSLAND

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

DIRECT EXAMINATION

BY JUDGE PALMER:

Q. And now if you give your full name, sir.

A. Yes. My name is Edward Crossland. I'm here on behalf of Lanco-Pennland Milk

E. Crossland - Direct

Producers.

Q. All right, sir. Give your statement.

A. Okay. As I indicated, my name is Edward Crossland. I serve as general counsel to Lanco-Pennland Quality Milk Producers, a Capper-Volstead cooperative, headquartered in Hagerstown, Maryland. In addition, I'm also engaged in the private practice of law. Personally I'm a former dairy producer, and but for the current milk price, would be a current milk producer. I am appearing before you today on behalf of Lanco-Pennland.

Our cooperative is comprised of over 840 farms located primarily in Pennsylvania, Maryland and West Virginia, and we market approximately 750 million pounds of milk annually. A substantial number of producers are Amish and Plain farmers. Our cooperative is a marketing cooperative. We own no plants, and our milk is marketed in the northeast as well as in the southeast.

We thank the secretary and his staff at USDA for holding this emergency hearing. We

E. Crossland - Direct

support the changes as proposed at this hearing by the National Milk Producers Federation because our farmers need immediate relief. We do not believe that this is any great solution to the economic devastation that's occurring on dairy farms across the country, particularly in our area. However, any relief that we can get is welcomed, especially if it's immediate.

This is especially true given the proposed changes in the make allowance for Class III and IV that would have a profound and detrimental effect on the producers in Midatlantic and southeast. The increases in the cost of production, most recently the spike and grain prices, coupled with the suppressed milk price, are preventing farmers from paying their bills. Our cooperative recently voted against these changes in the make allowance. A great disservice occurred to the dairy farmers of this country, particularly those in my area where the processing interests were put ahead of the farmers without any adjustments to Class I and II. So today we are here hopefully trying to gain some of the lost ground for

E. Crossland - Direct

farmers.

We are greatly concerned that the 77 cent increase as proposed is not nearly enough. We recognize and support the needs of the USDA to balance the interests of the public with affordable milk prices and the farmers' viability to produce that milk.

At this hearing you have heard from a milk producer in Pennsylvania, not a member of my cooperative, however, somebody that I am personally acquainted with and have known. He is an excellent dairyman and an excellent farmer. He and his family have contributed greatly to the dairy community, and as a farmer he is efficient, yet he is losing substantial amounts of money that's jeopardizing his business and his lifestyle.

However, the best estimate from Dr. Cryan is that Order 1, which is where virtually all of our milk is produced, will see a 35 cent per hundredweight increase, and our producers will see less than that in the monthly milk checks due to the net effect of the proposed Class III and Class IV make

E. Crossland - Direct

allowances. For the farmer that testified yesterday, his 400 cow dairy, it is at best a $12,750 increase annually in income. The average size our members' farms is 60 cows or so and, perhaps, even less. So the net effect on the bottom line for them will be minimal, but any relief that we can get is immediate and necessary.

We understand that the purpose of today's hearing is limited, but to ignore certain overriding factors in any discussion of milk marketing is a great disservice to the farmers and public in general. Our current milk marketing system simply defies basic economics of supply and demand and those costs associated with producing milk and getting it to the tables of the American people.

The increased geographical size of the federal orders, the pooling regulations and schematics that result therefrom, particularly in the southeast, and the ever present catelization of milk are overriding factors that distort the basic principles of economics. Due to the liberal pooling and diversions in

E. Crossland - Direct

the southeast milk marketing order, the farmers closest to the plants where the population growth is located are being penalized. Independent milk producers have been hit particularly hard. These factors prevent competition for the buyers of the farmers' milk and access to milk plants, thereby lowering farm gate milk prices and limit the choices of the consumers for dairy products.

If these issues are not addressed by the public and private sectors, we will continue to accelerate the loss of our dairy farm families, our rural economies, and businesses will suffer such as the one referred to by Secretary Wolff yesterday, and the public will ultimately suffer from a lack of steady, regional supplies of fresh milk and milk products.

We publicly thank the Commonwealth of Pennsylvania Secretary of Agriculture, Dennis Wolff, for taking the time to attend this hearing and supporting emergency relief for the farmers of Pennsylvania and surrounding states including my own of Maryland. He is a great friend to the dairy farmers of our area, and, again, we thank Secretary Johanns for holding this emergency hearing, and we urge the adoption of Proposals 1 through 5 on an expedited basis.

JUDGE PALMER: Are there questions? First of all, let me receive the statement as Exhibit 29. Questions? I think you are tiring. Thank you very much, sir.

(Exhibit No. 29 was received into evidence.)

JUDGE PALMER: Next witness.

MR. VETNE: Yes, I have.

JUDGE PALMER: Very well. Can you reveal that to us.

MR. VETNE: Neil Gulden.

JUDGE PALMER: We have marked Mr. Gulden's statement as Exhibit 30.

(Exhibit No. 30 was marked for identification.)

NEIL GULDEN

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

DIRECT EXAMINATION

N. Gulden - Direct by Mr. Vetne

BY MR. VETNE:

Q. Mr. Gulden, before you proceed with the prepared remarks which have been marked, can you say a little bit at the beginning about your experience and can you elaborate a little bit about your experience in the dairy industry and federal orders and testimony in federal order hearings.

A. Pretty much in my statement, Mr. Vetne. I have been working for Associated Milk Producers for almost 37 years now. It will be 37 years in January. And most of that, about 30-some years of that had been working as fluid marketing director or with the fluid marketing director in the early years and testifying at these types of proceedings.

Q. Throughout that period you have had a responsibility to analyze and make recommendations and advocate as necessary in federal order hearings?

A. Yes, sir.

Q. And you presented testimony as an expert in numerous federal order hearings which affect your region?

N. Gulden - Direct by Mr. Vetne

A. Yes, sir.

Q. All right. And you have prepared your testimony, as I understand, largely before coming here?

A. Yes.

Q. You sat through the hearings so far and listened to testimony?

A. For most of it. I came later Monday.

Q. Okay. Do you have any remarks in addition to that which you prepared in advance that you would like to make?

A. Yes. Just as an observation so far, I think there's one issue, and I think there's a great misconception as to the make allowance issue. I don't see that as much a cover-your-cost issue for manufacturers. I think that's taken care of in the marketplace. If you are going to cover your cost, it's going to happen in the marketplace.

What we're actually seeing in the make allowance is Class III and IV -- milk going to Class III and IV has not been able to get the same net blend price on the federal

N. Gulden - Direct by Mr. Vetne

order as milk going to Class I and II. Class III milk is priced in the order by the formula, and the make allowance has been less than needed in order to recover that Class III value to the marketplace. So if, and I say, if the 25 cents that has been announced in the tentative make allowance decision is right, I think it's too small, if it's right, then Class III handlers have not been able to get the Class III value out of the order -- I mean out of the marketplace. Hence, they have taken a quarter less blend return than handlers going to Class I and II.

So to me, it's an issue of similarly-situated producers in the same federal order not receiving similar blend prices, and that's what's happening with the make allowance. It's getting -- it's equalizing Class III handlers and IV handlers with Class I and II handlers in the blend plant and in getting the announced blend price out of the order. So that's a preface to my statement.

JUDGE PALMER: Do you want to

start your statement, sir.

A. Yes, sir. I am Neil Gulden, director of fluid marketing for Associated Milk Producers, Inc. My office address is 315 North Broadway, New Ulm, Minnesota 56073. I have been employed by AMPI for 36 years, the last 30 of which I have represented AMPI in most federal order hearing procedures.

AMPI represents approximately 4,000 dairy farmers in seven Midwestern states. Currently our milk is pooled in federal order 1030, upper midwest, and 1032, central. My testimony is in opposition to Proposals 1, 2, 3, 4 and 5 as offered by National Milk Producers Federation and NMPF.

AMPI is a member of National Milk Producers Federation, but certainly are not represented by NMPF on this issue. In their request for an emergency hearing on Class I and II prices, NMPF states their basis is directly related to the proceedings in docket No. AO-14-A74, et al.; DA-06-01, dealing with make allowance adjustments in the formulas for setting Class III and IV prices. They state

N. Gulden - Direct by Mr. Vetne

that any changes to the Class III and IV make allowances will also result in lower Class I prices for producers and that this will create unnecessary and unjustified economic hardships for dairy producers.

The fact is that formula pricing with fixed make allowances has gradually overstated Class III and IV prices relative to the value of the commodities used in those formulas, namely cheese, whey powder, butter and nonfat dry milk. To the extent that processing costs have increased since the late '90s when make allowances were determined, manufacturers of these products have not been able to realize the formula calculated Class III and IV return from the market value of these commodities.

On the other hand, since Class I and II prices are as a direct result of Class III and IV prices plus a differential, suppliers of Class I and II milk simply pass on these formula calculated minimum prices to fluid milk customers who are legally bound to pay them.

NMPF argues that if these make

N. Gulden - Direct by Mr. Vetne

allowances are increased to actual or increased at all, that suppliers of Class I and II milk should receive off-setting compensation.

In the absence of component formula pricing, the make allowances would not have even been an issue because the competitive price used prior to would have reflected the increased make allowances in the Class III and IV price, and consequently, in the Class I and II prices.

We believe that what has really been created by formula pricing without make allowance adjustments is an unintended increase of Class I and II milk prices and enhanced blend prices, the benefit of which was disproportionately based on utilization. NMPF's proposal now treats this price enhancement as an entitlement.

The fact, as NMPF states, that producers costs of milk production and supplying Class I and II markets has increased is indisputable. However, this is insufficient reason to effectively raise Class I and II differentials at all locations, as stated in

N. Gulden - Direct by Mr. Vetne

the Department's preliminary economic analysis on the NMPF proposal.

One of the key questions is whether there is an adequate supply of Grade A milk. USDA's agricultural marketing service's milk marketing order statistics for January through October of 2006 for all markets combined shows a Class I utilization of 37 percent. The balance, almost two-thirds of the federal order milk has to be used in some form of manufacturing either Class II, III or IV.

We contend that the federal order pricing system has created more than sufficient supply for Class I use. The federal milk marketing order program is a marketing program with the objective of assuring that fluid drinking milk markets are adequately supplied. There is no guarantee that all the milk needed will be produced or bottled in those same markets, but the fact that the system by setting minimum prices has created enough Grade A milk to get the job done is hard to deny.

Logistics may be more of a problem in some areas than others, but the system and

N. Gulden - Direct by Mr. Vetne

the marketplace have taken care of that through individual order regulations, plus over-order premium structures where needed. If there isn't enough milk year-round in some areas, the market finds the best way to get it there and should be allowed to continue to do so.

There are better regulatory tools with much less burden on producers and consumers for this purpose. These include expanded use of transportation credits, balancing payments and location adjustments in the producer blend prices to account for differences in raw milk value to the market in which the milk is pooled.

The issue as we see it is not whether cost of production and supplying the Class I and II milk have increased. The issue is whether the system has created the proper incentive to provide enough Grade A milk and if the markets are being adequately supplied. The answer to both of those is yes.

Effectively increasing Class I differentials 73 cents, and I guess that's 77 now under the proposal, per hundredweight

N. Gulden - Direct by Mr. Vetne

across all orders would certainly raise prices to dairy farmers, but very inequitably. A lot more to some in higher utilization markets and very little to those in predominantly manufacturing areas of the country.

It would most certainly create a supply response which would work its way back into the manufactured products and have a depressing price effect on Class III and IV prices. This would effectively turn the limited Class I benefit in a low utilization market into a net negative result.

Keeping Class I and II prices linked directly to commodity markets through the Class III and IV prices is important. Supply and demand does work and as long as the federal milk marketing order objectives, as we have discussed, are being met, effectively increasing Class I and II differentials would simply help some farmers at the expense of others.

The federal milk marketing order program is marketing tool, not a support price program. If USDA truly wants to help cover

N. Gulden - Direct by Mr. Vetne

dairy farmers' increased costs, one equitable way to handle any effective increase in Class I or II differentials would be to pool the revenue generated on a national basis.

Another alternative would be to make the price support program better reflect actual costs. I realize this is outside the ability of this proceeding, but as long as the link to Class III and IV is retained, it absolutely helps all dairy farmers.

Emergency marketing conditions. We believe that the emergency marketing conditions do not exist, especially in light of the short time frame between the hearing announcement and the hearing date. A recommended decision with ample time for comments is needed before any action by USDA, particularly in light of the possible ramifications and regional contentiousness of this issue. This concludes my statement.

JUDGE PALMER: We'll receive Exhibit 30. And do you want to proceed?

(Exhibit No. 30 was received into evidence.)

N. Gulden - Cross by Mr. Yale

BY MR. VETNE:

Q. Mr. Gulden, before people might ask you cross-examination questions, do you have any further comments that you wish to make?

A. Not at this time.

MR. VETNE: All right. The witness is available.

JUDGE PALMER: Who has questions? Mr. Yale.

MR. YALE: This is Ben Yale on behalf of Select, Continental and Dairy Producers of New Mexico.

CROSS-EXAMINATION

BY MR. YALE:

Q. Good afternoon, Neil.

A. Good afternoon.

Q. I have more of a general question. That is, I think what you are saying is that the Class I and II is already overpriced? Is that a true implication of what you are saying or --

A. I'm saying it's overpriced relative to -- relative to where it would have been with

N. Gulden - Cross by Mr. Yale

an unregulated -- without a formula price.

Q. Okay.

A. Yes. If we would have still had a competitive price like the old MW, it would have reflected the lower value that you are seeing coming through in the make allowances.

Q. So it's your testimony that the current spread is sufficient or is this current spread between the III and I, is that too wide?

A. At this point I don't have any real comment on that. I guess that could come out at some future hearing.

Q. You don't want it to go --

A. I just don't think there is any need to expand at this point.

Q. What would be the basis to know whether there was a need to expand the spread? What would you be looking for if you wanted to increase that spread?

A. I haven't given it that much thought. In fact, since I don't believe -- since I believe there's plenty of milk that's being produced and the fact that there aren't any -- that there isn't any problem getting

N. Gulden - Cross by Mr. Yale

milk to the market, I don't have any reason to think that there would be a need to expand it at all. So I wouldn't speculate on something I don't really believe is necessary.

Q. So in the III and IV, you see actual market conditions and supply and demand for those commodities dictating what this is worth?

A. Yes.

Q. And what you are saying is that there's an adequate supply to meet the demand for Class I, unless that switches to a higher demand versus supply, there shouldn't be any change?

A. That's basically right.

Q. Now, do you assemble milk and make it available for the bottling plants?

A. Yes.

Q. Is there any difference in what you do to assemble milk to the bottling plants than you do for the manufacturing?

A. No. And generally just a different location. That's all.

Q. The same amount of field staff?

A. Yes.

N. Gulden - Cross by Mr. Yale

Q. There's no difference in the cost to transport milk from the bottle as opposed to the cheese plant?

A. No. In fact, oftentimes with the geography we're in, there's more cost to transfer to a cheese plant than there is to a bottling plant.

Q. And what about the role of the Grade A, I mean do you have any Grade B producers who are members of --

A. About three percent of our volume who produce about five billion pounds per year, and about three percent of that is B milk.

Q. Is that priced the same as the Grade A?

A. No.

Q. Is it a higher price?

A. No.

Q. Lower?

A. It's a lower price.

Q. Is it indexed of the Class III or a separate price?

A. Simply a competitive price.

Q. And sometimes the spread then

N. Gulden - Cross by Mr. Beshore

between the B milk and A milk will spread or shrink depending on the market?

A. Depending on whether in an up-market or a down-market, it could shrink, but generally the spread stay on a year-round basis pretty close. Pretty much the same spread is what I'm trying to say.

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

JUDGE PALMER: All right. Questions? Yes, Mr. Beshore.

MR. BESHORE: Marvin Beshore for the Association of Dairy Farmers of the Northeast and Dairy Farmers of America.

CROSS-EXAMINATION

BY MR. BESHORE:

Q. Good afternoon, Neil.

A. Good afternoon.

Q. I apologize if I missed this in response with Ben. Were you asked how many of your producers are Grade B producers?

A. Well, percentage I told Ben that it was about three percent Grade B.

N. Gulden - Cross by Mr. Beshore

Q. Okay. What number --

A. Excuse me. Three percent of our volume.

Q. Okay. And what number of the 4,000 producers is that approximately?

A. I think it's about -- don't hold me to this. It's about 400 producers.

Q. In terms of your comments, make allowances, as I understand, to be more of an order -- an equity issue among producers than a cost issue? Is that fair in terms of what you said?

A. I think that's what I said, yes. And being a reference to how you receive the blend price from the federal order.

Q. Okay. And let's use the quarter of cheese as a proxy for that. So in essence, your analysis, the suppliers to, I guess, really cooperative cheese plants, since you have got the production, the ownership and the producer are one in the same in terms of blend price returns, the cooperative cheese plants were at about a quarter disadvantage on your analysis versus suppliers to Class I and II?

N. Gulden - Cross by Mr. Beshore

A. Only if you had 100 percent of your milk going to the cheese plant and there was 100 percent Class I of another competitor going to the buyer.

Q. So we'll talk about it in pure terms just to try to illustrate the issue. If it was a pure situation, you would be at about a quarter disadvantage?

A. Yes.

Q. That's why you think the make allowance is just adjusting it on making those returns from the order equal, whereas, they weren't before, correct?

A. Yes. It's returning the blend price, the announced blend price equally to all producers as intended.

Q. Okay. Now, let's assume that the supplier to the Class I and II had experienced cost increases to supply that market of 35 cents since the prices were set back in 2000. Okay. Now, who is a competitive advantage or disadvantage?

A. I don't think it has anything to do with that. I just think my only comment in

N. Gulden - Cross by Mr. Beshore

reference to the make allowance was that similarly-situated producers, they could be neighbors if they are shipping to different cooperatives, getting then a different blend price.

Q. But --

A. Because of the fact that the make allowance has not been adjusted.

Q. But only if the cooperative producer is experiencing that 25 cent margin reduction on its milk check, right?

A. Yes.

Q. If he's delivered a proprietary cheese plant, there's no problem, right?

A. Oh, I think there could be a problem.

Q. No problem in order prices?

A. No problem in order prices. But do you want me to expand on that?

Q. Well, I think we all understand. We all understand that no one is -- including National Milk is arguing about the problems of, you know, costs related to that. I'm just talking about the equity problem, exploring the

N. Gulden - Cross by Mr. Beshore

equity problem. Now, in order prices, if the Class I supplier has experienced, you know, an increase of 35 cents supplied in a market, he's got an equity problem in order prices, doesn't he?

A. No more than a cheese plant who has increased their costs. There's costs of increase to everybody.

Q. Well, you would say a quarter of the cheese plant. I'm saying 35 of Class I. Where's the equity problem now?

A. I guess he will have to absorb that problem in his operation just like the cheese man is absorbing that problem in their operation.

Q. Well, he'll have to absorb a dime more, perhaps?

A. Maybe on a particular instance as you described.

Q. Well, we were talking about pure hypotheticals, 100 percent Class I and --

A. Sure. Under that hypothetical, sure, I couldn't disagree with that.

MR. BESHORE: I think that's

all I have. Thank you.

JUDGE PALMER: Let's take a 15 minute break and be back here at 15 after the hour.

(Short recess taken.)

MR. VETNE: Mr. Vetne.

REDIRECT EXAMINATION

BY MR. VETNE:

Q. Mr. Gulden, I just want to address a couple of questions from cross-examination that you had. A series of questions of Mr. Beshore involved the hypothetical cooperative marketers one with milk going to its Class III or IV operations and another going to be Class I, and part of that hypothetical was that the producers going to the Class III, IV operation were suffering an unequal return under the order because the plant wasn't recovering the 25 cents, if that is the right amount, right?

A. Right.

Q. On the other side of the hypothetical was a cooperative supplier in Class I that incurred additional costs of 35

N. Gulden - Redirect by Mr.Vetne

cents to supply Class I, and I think, as I recall the line of questions, those producers -- given that hypothetical, those producers even with the old make allowance would net 10 cents less because they had 35 cent costs unrecovered. Do you recall that?

A. Yes, I do recall that question.

Q. There is, however, a difference in the ability of cheese makers to recover additional costs in the marketplace and Class I suppliers to recover additional costs in the marketplace because of the way USDA captures cost increases for manufacturing but not for Class I in the marketplace?

A. Based on testimony that I have heard here, there's been testimony that it is not a problem to pass on Class I any Class I increases to the bottling sector. I don't know if that's always true, but that's been testified to here. We are absolutely constrained on Class III and IV side based on market values and what the market is doing.

Q. Because if you -- well, if you and everybody else that sells commodity products

N. Gulden - Redirect by Mr.Vetne

pass it on, you all get a penny for penny equally higher regulated prices, thereby cancelling out their attempt to pass it on?

A. We could pass it on, but we don't have any sales. We can try to pass it on.

Q. Try to pass it on?

A. But market will determine that.

Q. Try to pass on, but if passed on, will not be passed back?

A. That's right.

Q. And the other line of questions, I'm not sure whom, involved your Grade B milk supply, Grade B membership to three percent. With respect to Grade B producers, your members and others, do they still have a lot of marketing options, the buyers, in Wisconsin?

A. I think that depends a lot on location, you know, would a cheese plant take a B producer just as easily as they would take a Grade A producer. I think that's probably -- I think they probably would. So I think it's a matter of location, where the producer is located. They don't have as much option, as many options as they used to just because

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there's less of them, and they might happen to be on the end of a Grade A route and be the only B producer on that route, and it's very difficult if you need that milk segregated for the Grade A market to have that producer on.

Q. You were involved in the federal order proceedings and analysis in the transition from the Minnesota, Wisconsin price to the BFP formula in the '90s to the current formula, correct?

A. Yes.

Q. Do you recall that one of the reasons USDA decided not to use surveyed competitive milk prices was because there weren't enough buyers to have a reliable survey result?

A. Yes. I remember that, yes.

MR. VETNE: That's all I have.

JUDGE PALMER: Any more questions? Mr. Tosi.

RECROSS-EXAMINATION

BY MR. TOSI:

Q. Good afternoon, Mr. Gulden.

N. Gulden - Recross by Mr. Tosi

A. Good afternoon.

Q. I'm Gino Tosi from the Department.

A. Yes.

Q. Are you basing your opposition to National Milk's proposal on the basis of how you see the outcome of the proposal with respect to having different impacts in different market places, or are you basing your opposition on the validity of whether or not there are actually higher costs being incurred by dairy farmers and supplied in the Class I market?

A. I don't dispute that there's higher -- as I said so in my testimony, I don't dispute there's higher cost. There's higher cost for all dairy farms, and so I'm not disputing that at all. My testimony states that I think there's plenty of Grade A milk, and I think the markets are being supplied, and I think the current system is handling that just fine, and I think that any increase in -- effectively increase in Class I differentials will create different outcomes for different producers, and some get more, some get less,

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and that's not the way I think that benefiting producers should be handled on an inequitable basis where some get more and some get less because the system is going to take care of -- in the long run, the system is going to take care of that, and you are only going to have so much money in the system. Okay. Some get more and some get less. You are going to have -- the long term you are going to have about the same amount of money, only some producers are going to have less, and they make a lot of business, and if you are to officially give more to other producers who will -- it really sends a signal to produce more milk, you know, if the differential really isn't needed for supplying the fluid market, you are sending a signal to produce more milk, and that is eventually going to have a depressing effect on the markets and, hence, III and IV prices.

Q. Well, you know, to the extent that you are going to talk about adequate supply, you know, to the extent that the upper midwest is -- let's just assume it's about 15 percent Class I utilization. Would it be reasonable to

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conclude that on the basis of what you are saying is that we really don't even need a Class I differential, just let the market take care of whatever it needs to get the milk to Class I plants?

A. Could you do that?

Q. Well, I'm -- I don't know yet.

A. Well, I haven't opposed that yet, but it's a heck of an idea, and I'll think about that. So I don't know if you don't need them. I think you needed them at one point years ago, and that there wasn't enough milk being produced in some areas of the country even to supply them what they needed in times of the year when they -- let's say in times of the year where they -- there was a true shortage in some areas at one point. So you needed some incentive to either move the milk from where the milk was or to create a local supply, and I think we have created a local supply everywhere, and I don't think you can name hardly any place that doesn't have enough milk in the area for Class I milk usage, except maybe Florida, and that's not even year-round.

N. Gulden - Recross by Mr. Tosi

Q. Would you say the same would be true of southeast?

A. Yes.

Q. Southeast marketing area? Excuse me.

A. Well, yes, that on a year-round basis they have certainly got enough Grade A milk. They may import more at one time of the year and export some at another time of the year, but that's just a matter of the way their market is -- the way their market operates.

Q. Would you be of the opinion then that the current differential level in the upper midwest is too high?

A. Relative to other differentials, no. You know, I'm of the opinion that differentials by themselves, if you are just going to look at differentials, that there's enough milk produced in this country where you don't need those kind of incentives anymore. I think there's milk located -- there's been enough Grade A milk produced in this country in areas that used to be short that now you don't need to move milk very often from the midwest to

N. Gulden - Recross by Mr. Tosi

those former deficit areas. There's milk in between that can move to those deficit areas. There's just situations in the industry that have happened, consolidations and what have you, where you have certain supply agreements that people cannot -- that other entities cannot access a certain market, and that maybe the reason that it costs more to move milk is because of somebody's internal decision that they are going to be the ones supplying that milk, and there may be somebody closer that could supply it, but they don't have access, and I think that's the case in a lot of situations and a lot of markets.

Q. Would you be of the opinion that the Class I differential in the upper midwest is creating the incentive to produce an excess amount of milk there?

A. I think it has produced more milk than the fluid market needs.

Q. And that's having a depressing price then on -- excuse me -- a depressing effect on the Class III and IV prices?

A. No. I think it's more a result of

N. Gulden - Recross by Mr. Tosi

people just wanting to get pooled on the federal order. The midwest is losing milk. They are not gaining milk. This isn't an increasing market in the midwest on milk supply.

Q. I wanted to just probe a little bit more here. Assume for a moment that the upper midwest Class I utilization is about 15 percent, and let's say it's about 90 percent in Florida; okay?

A. 90 percent what?

Q. 90 percent in the Florida market, Class I.

A. Okay.

Q. And let's assume that we have the same level differential. Let's say it's $2.00. Would the blend price in both orders be the same?

A. I wouldn't think so.

Q. Is that inequitable?

A. Is it inequitable to have the blend prices the same?

Q. Yes, sir. Wait a minute. Repeat that back to me. I may have misheard you, sir.

N. Gulden - Recross by Mr. Tosi

A. Did you say is it inequitable to have the price --

Q. No. Is it inequitable that we would have two different blend prices?

A. When you use the example of Florida, that's the ultimate -- that's the ultimate market who is short. I don't see it as much in Florida, you know, as I would in other areas. You know, if you have enough milk for the fluid market, and I keep going back to that, then I think any blend prices that are different is inequitable.

Q. And to differences in the blend price?

A. Yes.

Q. And oceans of markets have different utilizations, and, in your opinion, that would have secondary importance of their impact on prices that dairy farmers receive?

A. I don't know the exact differential or right differential for every order. I haven't looked at that in depth. All I'm testifying really to, Gino, is I think that the current differentials have done a magnificent

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job of producing milk. They have created milk in areas that never had it before. They created supplies that never had it before, and I think there's plenty of milk for Class I use in most areas, except maybe Florida, and that we don't need to increase Class I differentials to supply the market in most areas, at least on an overall basis. I think that should be done -- if it needs to be done, it should be done on a market-by-market basis.

MR. TOSI: Thank you, Mr. Gulden. That's all I have.

JUDGE PALMER: Let me see if I understand you.

EXAMINATION

BY JUDGE PALMER:

Q. You keep talking about Class I differentials, and maybe I misunderstood what was being proposed. I understood it was the Class I prices that was going to be changed, not a differential, but the Class I price itself. Isn't that the proposal?

A. That's the proposal is that there

N. Gulden - by Judge Palmer

remains the --

Q. You referred to it as a differential. But it's the Class I price?

A. Right. Class I formula.

Q. Class I formula?

A. Yes.

Q. As the Class 1 formula price increases, if you have the same supply going to Class I, the same amount of milk going to Class II, III and IV, the blend price would increase theoretically, would it not?

A. Yes. My reference to Class I and II differentials, Your Honor, is just in reference to what USDA's model -- or what their statement was in their economic analysis is that it has the same effect as raising Class I and II differentials.

Q. Let me see if I do understand now. So the blend price will go up if this proposal were done, and all farmers, including your farmers, even if they are supplying mainly to Class III, would get an increased price, would they not?

A. From the Class I differential, yes.

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Q. But your concern is that it will bring forth more milk to the pool, and overall what will then happen, Class III users will buy more milk? Does that break down the blend price?

A. No. What I see happening is that on a national basis this will create more milk and that there is only so much usage for Class I. It's static. I didn't mean to use that word. It's stable.

Q. Stable?

A. It's not going up very fast. If at all, it's probably more declined over the last 10 years on Class I usage. So that milk has to go into a manufacturing product, and when that happens, you are going to depress those markets because your supply is going to go up relative to demand.

Q. Your organization, Agri-Mark, supplies two market --

A. AMPI.

Q. I'm sorry. Forgive me.

A. That's all right. They are a good organization.

N. Gulden - by Judge Palmer

Q. AMPI supplies are Order 30 and Order 32?

A. Yes.

Q. Will this affect the amount of milk -- if this change were adopted, will it affect the amount of milk going into Order 30 or Order 32?

A. I think long-term it will affect the amount of milk that we have left to pool in those orders because I think it will long-term depress our prices enough up in this part of the country.

Q. How is it going to depress your price? I'm lost on that. The blend price is going to go up on short-term, correct?

A. Yes.

Q. So your producers are going to make more money. Now, I know you also have an operating factor where you operate balancing plants and so forth. Is that where the effect is coming in?

A. The effect is on the manufacturing side and the value of the commodities once these prices go into effect. It won't be

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immediate. It's going to be a long-term effect, but it is going to raise milk production more so in areas outside the upper midwest than the midwest.

Q. How does it affect the two orders that you basically pool milk in?

A. It affects us because it's going to depress commodity markets which is our life-line. We have got 85 percent of our milk going into commodities, and so if it depresses commodity markets, it will depress the Class III and IV price, and we will have more negative out of this than we will have positive coming from the Class I differential that increased.

Q. Now, when you say depress the commodity market, you mean there's going to be more milk coming onto the market altogether?

A. Yes.

Q. Because they are chasing the Class I? They are going to be chasing this higher Class I product?

A. It's going to come on the market because of increase incentives to produce milk

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because of a higher price.

Q. This is really blend price, not the --

A. Yes.

Q. So they'll come on the market. And now they will be in competition with you for your Class III --

A. No. Extra milk that they are going to produce is going to flow into the commodity markets. It's going to flow into the manufacturing markets.

Q. That will bring down a price for Class III?

A. Yes, sir, which has been testified to here.

Q. The real price for Class III?

A. Yes.

Q. We're not talking about the order price because the order price is fixed by the --

A. Right. But that's been testified to by Dr. Gould as to the economic implications of this on a regional basis.

Q. You are receiving, are you,

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something more than the Class III price for milk -- or Class III and IV prices going for these other uses, you do receive some sort of a premium for that?

A. Well, we can return out of the market now as less than what the Class III and IV formula has calculated.

Q. How is that? How does that happen?

A. The calculations in the federal order now are fixed, have a fixed make allowance in them, and that hasn't been adjusted since the data -- the data that was used for that was back in about 1998 for cost of producing -- or cost of turning milk into commodity products. So that allowance is fixed in the federal order and has not been adjusted.

So if you have a make allowance that hasn't been increased, you automatically have a Class III and IV price that is overstated relative to what you can get out of that -- relative to what you can get out of the marketplace.

Q. Now, you are a coop. You are sending milk to somebody using it for Class III

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and IV, and there's a make allowance. Now, the person that buys that milk from you based on Class III and IV price but gets a deduction for the make allowance, and you say the make allowance isn't high?

A. The make allowance -- we handle all our own milk.

Q. I see. So you have to pay the III and IV prices?

A. Effectively, yes. Our effective settlement with the federal order pool is at III and IV prices.

Q. So really you are being affected as a cooperative doing this handling function?

A. Well, we're being affected as a cooperative because we can't get the value of the Class III and IV out of those products, and in effect, we end up getting a lesser blend price than other people.

JUDGE PALMER: I'm going to leave it there. I do always get puzzled with the way the money flows with the milk. We'll leave it there. Other questions? I think you are finished. Thank you, sir.

D. Tonak - Direct by Mr.Vetne

(Discussion held off the record.)

JUDGE PALMER: This is Dennis Tonak. Mr. Vetne, do you wish to question?

MR. VETNE: Has the statement been marked?

JUDGE PALMER: It's 31.

(Exhibit No. 31 was marked for identification.)

DENNIS TONAK

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

DIRECT EXAMINATION

BY MR. VETNE:

Q. Mr. Tonak, you prepared a statement. Does that include your Curriculum Vitae, your experience and history?

A. Very briefly.

Q. Very briefly. Okay. And you will explain during the course of your testimony?

A. That is correct.

Q. Okay. Any comments you want to make before you testify?

A. No.

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MR. VETNE: All right. There is, however, Your Honor, an additional document to which Mr. Tonak will make reference, perhaps, not in the prepared statement, but will make reference. I would like this marked.

JUDGE PALMER: Do you want to mark it?

MR. VETNE: Yes.

JUDGE PALMER: 32. I'm receiving Exhibit 32. It's published by Department of Agriculture. This is Wisconsin Administrative Code. We would and will make official notice of this, but for convenience sake, we're receiving it as an exhibit. So Exhibit 32 is received.

(Exhibit No. 32 was marked for identification and received into evidence.)

MR. VETNE: Thank you.

BY MR. VETNE:

Q. Mr. Tonak, ready to proceed?

A. Yes.

Q. Read.

A. My name is Dennis Tonak. I'm the general manager of Mid-West Dairymen's Company,

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4313 West State Street, Rockford, Illinois 61102. I have over 30 years of experience in dairy marketing and federal order issues, especially in the geographic areas east of the Rocky Mountains. Prior to my employment with Mid-West Dairymen's Company, I was employed with the National Farmers Organization In Ames, Iowa and Southern Milk Sales, San Antonio, Texas in various marketing and management positions.

This testimony is on behalf of Mid-West Dairymen's Company, Manitowoc Milk Producers Cooperative, Milwaukee Cooperative Milk Producers and Lakeshore Federated Dairy Cooperative in opposition to Proposals 1, 2, 3, 4 and 5. Lakeshore provides a vehicle through which Manitowoc, Milwaukee and Mid-West participate in developing direction on dairy policy, legislative activities and federal order issues. Lakeshore also provides other services and benefits to the members.

Manitowoc, Milwaukee and Mid-West are all recognized as Capper-Volstead cooperatives approved to provide federal order

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marketing services. We are concerned about producer income both near and long term. We welcome efforts to improve producer income but prefer solutions that treat all regions equitably. Mid-West has 157 farmer members located in northern Illinois and southern Wisconsin. The members' milk is currently pooled on Federal Order 30 and is used to supply fluid milk plant, Muller Pinehurst, owned jointly by Mid-West and Prairie Farms Dairy. Mid-West also supplies other fluid and manufacturing use plant. Mid-West is a small business under the criteria established in the hearing notice. Virtually all of Mid-West producer members are small businesses. Mid-West is a member of the National Milk Produce Federation.

Manitowoc Milk Producers Cooperative has headquarters in Manitowoc, Wisconsin and has approximately 3,000 dairy farmer members. The majority are located in Wisconsin with the balance in surrounding states. Manitowoc provides marketing services for their members. The milk is pooled on Federal Orders 30 and 32.

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The farms deliver milk to both pool and non-pool plants. For purposes of this proceeding, Manitowoc is a small business. The majority of Manitowoc's producer members would meet the small business definition. Manitowoc is a member of National Milk Producers Federation.

Milwaukee Cooperative Milk Producers is headquartered in Brookfield, Wisconsin and has approximately 700 dairy farmer members. The producers are located from eastern Nebraska to northern Indiana with a majority located in Wisconsin. Milwaukee provides marking services for their members. The milk is pooled on Federal Orders 30, 32 and 33. The farms deliver milk to both pool and non-pool plants. For purposes of this proceeding, Milwaukee is a small business. The majority of Milwaukee's producer members would meet the small business definition.

National Milk Producers Federation speaks with one voice on behalf of the nation's dairy producers on many issues; environment, animal health, food safety, to name a few. On the issues before this proceeding, National

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Milk is only speaking for a sliver of those dairy farmers affected by this regulatory process. It is apparent that National Milk does not speak for a number of its member cooperatives, Mid-West, Manitowoc, AMPI, First District, Prairie Farms, to name a few, on these proposals. Many of the larger NMPF members, Land O'Lakes, DFA, California Dairies have producers located in areas not regulated by federal orders or market milk not pooled on federal orders.

As an example, there is not a federal order in California, the largest milk-producing state in the nation. The heavy milk production areas is Idaho along with Utah are outside of federal order boundaries. Most of Pennsylvania and some of New York are outside of defined federal order areas. Members of National Milk have producers in these areas that are outside of the federal order marketing area boundaries.

There are also cooperatives who are not members of National Milk who do not support NMPF's proposal.

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Historical perspective. Our approach to this proceeding is shaped by our view of the changes in milk marketing over the years. The role of federal orders evolved as changes in milk production, food processing and transportation developed. In the earliest days of the order program a marketing area was relatively small, may have involved only one population center and milk production and transportation characteristics defined milk movement. Bulk tanks at the farm level were non-existent. Milk was delivered to plants in cans, often cooled only with well water. Electrical power was limited. It was necessary to maintain a locally-produced milk supply to meet the fluid milk needs of the local population.

When federal orders were initially formed, it was difficult, if not impossible, to meet an area's fluid milk needs with milk production from distance locations. I will digress here to say that it is difficult to define local or distant milk, but even when I can't define it, I know what it is when I see

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it. Now milk is quickly chilled at the farm which greatly improves the quality. Interstate highways aid in the quick movement of both raw bulk milk and packaged milk from the production areas to the consumption areas. In this day and age, milk movement over distances of 1,000 miles or more can be readily accommodated. Due to the changes mentioned above, the fluid milk needs for a population center can now be met with milk production from areas quite distant from that population center. We have changed from a local industry meeting local needs to a national industry capable of meeting local needs.

In the early days of the federal orders a Class I price which was higher than the price for milk used in producing storable dairy products helped to assure the production of milk for fluid use. The extra money found in this higher Class I price helped recover the added costs of producing Grade A milk and delivering the milk to the fluid-use market. The Class I money was not widely shared. Individual handler pools were common. Access

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to participation in some federal orders was tightly controlled by either the fluid handlers or milk supply cooperatives. They wanted to retain the Class I money for those who actually delivered to the fluid market and those who did not deliver to the fluid market and deny those who did not deliver to the fluid market access to the pool proceeds.

As an example, in the early 1960's producers in the Rockford, Illinois area wanted their milk pooled on Order 38, the Rock River Valley Order, and not on the larger Chicago order which had a lower Class I use percentage and a lower producer price. A local Rockford dairy cooperative exerted great influence on who had access to the Order 38 pool.

USDA, in an attempt to correct these disorderly marketing conditions, oversaw the mergers of a number of federal orders from the late 1950's into the 1970's. It is during this time that the value difference between the Class I price and the manufacturing price started to shift from A, where Class I money attracted milk to fluid use to B, where Class I

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money through the blend price attracted milk to the federal order pool, or perhaps, it would be more correct to say that this functional shift from A, where Class I money attracted milk to fluid use to B, where Class I money through the blend price attracted milk to the federal order pool. This change became more pronounced and noticeable.

As more milk entered the larger pools, milk was encouraged to move to fluid use through negotiated premiums, location adjustments on producer milk, shipping requirements and diversion limitations. The Class I price, since it was shared with all pool participants equally and not just those who supplied the fluid use, was not sufficient standing alone to cause milk to move to fluid use.

Money moves milk, more money moves more milk, much more money moves much more milk, unless the money comes from a mandated Class I price increase. Since the Class I price in and of itself no longer moved the milk to the fluid market and covered the costs, due

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to the sharing with all pool participants, over-order premiums emerged as a primary means of attracting milk to fluid use. The over-order premiums are generally retained by those who supply the fluid market. Over-order premiums are not shared with the federal order market-wide pool. In fact, over-order premiums now serve the same purpose as the Class I prices did in the early days of federal orders, that is to attract milk to fluid use.

What purpose does the Class I price serve today? It attracts milk to market-wide pool. The shipping and eligibility requirements along with the transportation and assembly credits where available encourage some milk to have move to fluid use. In the upper midwest order 10 percent of the pooled milk is required to move to fluid use. The balance of the upper midwest fluid milk needs are drawn to fluid use by the over-order premiums. Thus a major paradigm shift in the purpose and function of the Class I price has occurred.

As this shift in the function of the Class I price has occurred, an effort has been

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made in some orders to partially off-set the costs of supplying milk for Class I use. Order 30, as an example, has an assembly credit provision and transportation credit provision to aid those who supply milk to fluid use. In a general fashion, the money is generated from the Class I price, actually from the pool proceeds before the pool proceeds are distributed to all pool participants.

These type of credits, along with the ability to share in the overall pool proceeds by meeting the required minimum shipping/pooling requirements, are all that the federal orders provide in the way of an incentive to ship to fluid use. Once you meet the minimum requirements of the specific order, there is little incentive from the order to make extra shipments for fluid use.

Historically, the Class I price has been directly linked to prices for manufacturing milk. Since at least the early 1960's, the Class I price has been based on the Class III price, either directly or through a product price updater. This historical

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relationship was maintained with the initial completion of the federal order reform process in January of 2000. The Class II price has also been based on a manufacturing milk price. The NMPF proposals, while maintaining some relationship with product prices, completely divorces the Class I and II prices from the Class III and IV prices. The insulates the Class I and II prices from the realities of the marketplace as changes occur. The National Milk proposal is an attempt to do an end run around 40 plus years of federal order policy.

General comments. There is not a crisis in national milk production. No change in Class I price formula is required. Per capita milk production has increased from 592 to 597 pounds between 1995 and 2005 on a national basis according to the Marketing Service Bulletin from the Order 32 market administrator. This has occurred during a time when milk prices have not been particularly profitable according to many accounts.

Milk production nationally has climbed over nine billion pounds since order

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reform. Class I usage has not seen a similar increase, Attachment A and B. Attachment A and B were compiled dairy marketing statistics from 2000 to 2005, published in April 2001 through 2006. The table that was used is identified -- in the case of Attachment A, table 32, annual price and pool statistics. It lists the producer receipts and million pounds, and you see a climb of 117 million, 120 million, 125 million, 110 million, 103 million and 114 million. Keep in mind that during this time the western federal order had been terminated, and as you can see, the Class I utilization within the federal order pool has remained relatively stable. You could even say it's gone down.

Attachment B was compiled from the same dairy market statistics. Table 1 is the milk production pounds. Where they were available, we used the latest revised figures. So 2000 through, I believe, 2004 of the revised figures were in 2005 is the initial publication in the April 2006. Table 29 from that same publication is packaged sales of fluid products

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in million pounds. This includes California federal orders and the estimated eight percent of fluid milk product sales that are not captured in California federal order statistics. As you can see, total milk production has climbed by nine billion pounds while total fluid consumption has increased by less than three billion pounds.

The industry's ability to increase milk production capacity under very trying circumstances, extended periods of low prices, high production costs, especially feed costs and low farm returns, continues to amaze me.

In a perfect world, we could develop a system that allows every producer to recover all costs associated with producing milk. This is not a perfect world. I have not seen any indication that USDA or any other government agency is about to embark on a journey which would accommodate all dairy farmers in the recovery of all their milk production costs. The proposals by National Milk will enhance some producer income, and do so on a regionally inequitable basis, without regard for economic

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reality or the natural forces of the national marketplace.

There is not a large supply of non Grade A milk to recruit to Grade A status. My estimate is regular non Grade A milk production is slightly over 2.5 billion pounds. About one-third of that milk is produced in Wisconsin. Another one-third is produced in the combined states of California, Minnesota and Ohio. Generally the non Grade A milk is found in the northern states and nonexistent in the southern states.

Attachment C is from a USDA publication of dairy and poultry statistics. It had a dating on it of 2006, I believe, even though the 2003 preliminary data is the most recent numbers I could find, and you can run down through the right-hand column and see that in many states 100 percent of the milk produced is Grade A milk with the exception of North Dakota and Wyoming. All states with manufacturing Grade A milk were over 90 percent.

There is currently more than enough

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marketplace incentive to prompt those producers with the desire and management skills to produce Grade A milk to make the transition. A non-Grade A producer in southern Wisconsin recently upgraded his dairy barn and milk room and began shipping Grade A milk. One of his largest expenditures was for whitewashing, a form of painting his barn. He also needed to repair some floors and the fit of a few doors. His total out-of-pocket cost was less than $500. He is shipping and average of $2,979 pounds of milk per day.

Over the course of the year, his cost to convert to Grade A would be .46 cents per hundredweight. Another Grade A producer with 8,796 pounds of daily production drilled a new well at a cost of approximately $12,000. If he had not drilled the well, he would not have maintained Grade A status. A new well will often last for 20 or more years. Amortization of the $12,000 cost over a short five year period would give a cost to maintain Grade A status of .0748 per hundredweight. While individual situations may vary widely

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depending on expense factors and milk production, these two examples illustrate that it does not take much money to justify maintaining or upgrading to Grade A status. Perhaps that is why such a large percentage of the nation's milk supply is Grade A.

Feed costs, labor costs, costs of cleaning equipment, et cetera, do not change appreciably between the production of Grade A milk or non Grade A milk. The cost of producing milk does not change as the utilization of Grade A milk changes from Class I or II to Class III or IV. A Mid-West member-producer's costs do not miraculously change when milk is diverted from fluid use to be manufacturing use.

Mid-West is responsible for supplying the total raw milk needs of Muller-Pinehurst Dairy, an Order 30 pool distributing plant. The milk needs vary week to week and month to month over the course of the year. Mid-West balances Muller's raw milk needs through a combination of buying supplemental supplies from other pool handlers or selling

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milk to non-pool manufacturers, primarily cheese plants. When we look at Muller's milk needs over the course of the year and then arrive at an average or base-line, we find that there is a deficit situation for about six months and a surplus situation for about six months.

During the past two years the surplus side has ranged from a high of 2,442,807 pounds in an individual month to a low of 12,945 pounds with an average on the surplus side of 1,501,497 pounds per month. The deficit sees similar numbers ranging from a shortage from the base-line of 3,057,134 pounds to 708,676 pounds depending on the month with an average of 1,637,997 pounds. Variations from week to week are also present.

In December Muller's weekly milk needs will change by an estimated 1.2 million pounds from early December to late December. These fluctuations in demand must be balanced. When Mid-West purchases supplemental milk for Muller-Pinehurst, Federal Order 30 establishes a minimum Class I value. The value is shared

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with all pool participants. It is not retained by Mid-West or paid directly to the supplemental milk supplier. Other than the assembly credit and transportation credit received from the pool proceeds, there is no direct incentive from the Class I price or the pool proceeds to ship milk to fluid use. The incentive to ship supplemental milk comes from a payment to the supplemental supplier in the form of an over-order premium.

It is the over-order premium that helps the suppliers of supplemental milk cover the transportation costs to the fluid market, the costs of daily and seasonal balancing through a manufacturing plant and any give-up charges. The minimum federal Class I price does not cover any of these costs as they are incurred by the regular supplier, Mid-West, or the supplemental supplier.

When Muller-Pinehurst's milk needs move lower, a surplus develops. At those times Mid-West balances milk supplies by moving the surplus milk to manufacturing plants. Mid-West does not receive any money from the federal

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order pool in return for performing this balancing function. The order minimum Class I price paid by Muller-Pinehurst does not pay for any of this surplus balancing cost. The costs of this function are paid for by Muller-Pinehurst through over-order premiums or absorbed by Mid-West.

The seasonal swings we see at Muller are not that much different from the seasonal variations seen in Florida. The comparison of an average base-line at Muller's and Florida milk imports and exports may be somewhat of an apples and oranges comparison, but it is still a valid comparison. The combined Florida and southeast imports and experts are higher in 2005 than in 2001, but the import/export volume difference has lessened when 2001 and 2005 are compared.

Attachment D, this, again, is from the dairy market statistics. Table 27. It reports for 2002 through 2005, released in April 2003 through 2006. The first year that we saw this information was in the 2002 report, and it included both the year 2001 and 2002.

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If we totaled the imports into Florida and into the southeast, the total of those two is 3,492 loads, and this is loads of milk incidentally. The export would be 2,919 loads for a difference of 573 loads. In other words, Florida imported 573 more loads in the fall of the year in 2001 than they shipped out in the spring of the year. When we drop down to 2005 and look at those same statistics, the number of loads imported and exported both increase to 4,690 loads imported in the fall, 4,451 loads exported in the spring, but the difference between the two has decreased to only 239 loads.

The changes proposed by NMPF will enhance pool proceeds, at least in the short term. The changes to the blend price will vary widely in different parts of the country. The upper midwest may see a short-term 15 cent per hundredweight improvement where Florida may see over 65 cents.

These price increases will be paid directly to producers. More milk will be produced. Since Class I consumption has been

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relatively stable, the additional milk production will end up in cheese and butter and other manufactured dairy products. This will undoubtedly lead to lower prices.

Simply put, a higher Class I price leads to more milk which leads to more cheese which leads to lower cheese prices which leads to lower milk prices. The impacts of the lower cheese prices will hit the areas with more cheese manufacturing such as the upper midwest first and hardest.

We are also concerned about the impact of a non marketplace driven price increase on consumption. USDA used a price elasticity factor of negative .05 in their analysis of this proposal. Chapter 3, the Cornell Analysis, table 3-1 of the USDA report to congress on the national dairy promotion and research program and the national fluid milk promotion program from July 2006 used a factor of negative .114.

I am not an economist, but these different elasticity factors raise questions. Is it possible that the increase in the Class I

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mover proposed by NMPF will reduce Class I consumption by over double the number contemplated in the USDA analysis, and what we're talking about, the double is minus .05 compared to minus .114. If the negative elasticity factor is doubled, does that mean that impact on lower consumption is doubled.

It is our view that the changes in the milk and competitive beverage segments in the marketplace are leading to much larger elasticity values than traditionally believed. It is within the realm of possibility that we are actually approaching an elasticity value closer of that of other dairy products. If this is true, we could easily see a one to two percent decrease in milk consumption with the artificial five percent increase in the proposed changes to the Class I price mover.

The large change in the Class II butterfat price formula causes us great concern. Along with fluid milk, the Muller operation also produces ice cream. The ice cream production helps us balance our milk needs. There is limited ice cream produced in

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the winter months with heavier production in the summer. Muller would face an increased Class II butterfat cost while a stand-alone ice cream plant, and this is becoming quite common, could find butterfat sources from outside federal order price regulations. Cream moves from unregulated areas in the west to butter churns in the midwest. That cream could just as easily move to a stand-alone ice cream plant. This would put the Muller ice cream operation and any other ice cream maker embedded in a fluid plant operation at a great disadvantage.

Emergency conditions. Emergency conditions do not exist. There is a more than adequate supply to meet the Class I and II needs of the marketplace. The NMPF proposals request a major shift in how Class I and Class II prices are determined. Changing from Class III and IV milk price formulas with a differential value to a decoupled product formula for the determination of Class I and II prices should not be undertaken on an emergency basis.

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The short notice time for this proceeding also begs that all views be fully and completely aired and commented upon before any change is made to the current regulations. Thank you for your consideration.

Q. Mr. Tonak, in your testimony you referred to -- you discussed some illustrations of the cost of converting Grade A and Grade B that are maintained in your area, and this was Wisconsin?

A. Right.

Q. And Wisconsin has published its Grade B and Grade A standards in one publication?

A. That is correct.

Q. And you are familiar with that publication?

A. Yes, I am.

Q. That's the publication that's been marked as Exhibit 32.

A. Would you like me to discuss it a little bit?

Q. Yes, I do. To help the people listening here and maybe a means to -- because

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that's a long publication in very tiny print. So I'm going to ask you to look at an article here which might have a shorthand reference to some of those differences.

MR. BESHORE: Your Honor, he can talk about the publication without having an article written by somebody else in front of him to provide an outline providing he's knowledgeable. I assume he is.

JUDGE PALMER: I think he's talking about the --

MR. BESHORE: He's not. He just handed him an article written by somebody from somewhere and said, can you use this as an outline to tell us about this 32. I object.

MR. VETNE: Notwithstanding Mr. Beshore's objection, I'm not going to ask this document that I handed him be marked as an exhibit because it does nothing more than reduce from 40 pages in small type to one paragraph of readable type. I'm handing this out so that people can follow easily for convenience.

JUDGE PALMER: It's not been

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offered. So we have really nothing to --

MR. BESHORE: Then I object to it even more. He's giving him something that's not going to be in the record to use as an outline to testify from.

JUDGE PALMER: He can use whatever he likes. I don't know care if he has handwritten notes.

BY MR. VETNE:

Q. Could you identify, Mr. Tonak, in the Wisconsin regulations that have been marked and identified as Exhibit 32, what differences under those state regulations there are for Grade B versus Grade A milk? And for those that would like, I have a shorthand reference I have here, this publication, article on page 4 which gives all those things in one paragraph, easier to follow. But you can you identify those?

A. Yes. I can tell you that there's differences. The bacterial count for Grade A milk, the maximum limit is 100,000. For manufacturing Grade milk, it's 300,000. There is a requirement on cooling that for

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manufacturing grade milk requires that milk be cooled to 50 degrees. For Grade A milk, it requires that the milk be cooled to 45 degrees. Other than that, the regulations for Grade A milk and Grade B milk are virtually identical. The regulations, if you want to look at the fine print, require the same -- meeting the same code requirements for your well water for Grade A milk as for Grade B milk.

There is no difference identified in facility construction or maintenance for Grade A milk or for Grade B milk. There is one other relatively significant difference, and that is if you are a Grade B producer, you only get inspected once every two years. If you are a Grade A producer, the initial requirement is that you get inspected twice a year, but if you do a real good job of producing quality milk, you will only get inspected once a year. If you do a fairly poor job of producing quality milk as a Grade A producer or you do not maintain your facilities, you are going to get inspected every three months.

As a consequence, some producers

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would rather take a slightly less price or even a lot less price and only deal with an inspector every two years instead of dealing with an inspector every three months, and those are the basic differences.

Q. And those differences have narrowed in recent years?

A. At one time there was a difference in somatic sale. The somatic requirements are exactly the same for Grade A milk and Grade B milk.

MR. VETNE: Your Honor, I think I may have unintentionally confused things a bit. I intended to make the reference helpful for participants by providing this article of the Wisconsin differences, and instead, it has produced a bit of consternation. I intended nothing nefarious, nor did I intend to.

JUDGE PALMER: We would never think you would intend anything --

MR. VETNE: Nor did I intend to cause people not to pay attention to Mr. Tonak's testimony as it appears it has

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done.

BY MR. VETNE:

Q. Does that conclude your testimony, Mr. Tonak?

A. That concludes my testimony.

MR. VETNE: I have asked that both be received, if they haven't been.

JUDGE PALMER: They are both received, 31 and 32. Questions? Mr. Beshore.

(Exhibit Nos. 31 and 32 were received into evidence.)

MR. BESHORE: Marvin Beshore for the Association of Dairy Cooperatives in the Northeast and Dairy Farmers of America.

CROSS-EXAMINATION

BY MR. BESHORE:

Q. Good afternoon. Let me start by asking a little bit about Mid-West and Muller-Pinehurst. Does Mid-West have an ownership interest in Muller-Pinehurst?

A. Yes. We own 50 percent of Muller-Pinehurst.

Q. Muller-Pinehurst herself has two

D. Tonak - Cross by Mr. Beshore

processing facilities?

A. One.

Q. It has one. At which you produce both Class I and Class II products?

A. That is correct.

Q. And that facility is where?

A. Rockford, Illinois.

Q. Does Mid-West own any other manufacturing facilities?

A. We do not own any other manufacturing facilities that would be involved here, but we do have a cheese packaging operation, but we do not produce cheese.

Q. Okay. You have a cheese packaging operation. Where is that located?

A. Shullsburg, Wisconsin.

Q. Whose cheese do you package?

A. Well, we package it under Shullsburg creamery label and other labels. We source cheese from various manufacturing plants including plants that on occasion divert milk to it.

Q. Okay. Is there a cheese plant associated with the packaging facilities in

D. Tonak - Cross by Mr. Beshore

Shullsburg?

A. There is not an operational cheese plant there. Now there used to be, Marv, but it went broke about a year ago.

Q. Okay. How far is Shullsburg from Rockford?

A. 74 miles.

Q. Your 157 farmer members, where are they located with reference to the Rockford plant?

A. Those producers would be within about a 60 mile radius.

Q. How many cheese plants are in that same 60 mile radius of Rockford?

A. Well, there's an additional two plants that have shut down this year. So that leaves probably about eight small cheese plants and one larger plant.

Q. Okay. What's the larger plant?

A. The Grande in Juda, Wisconsin.

Q. How far is that from Rockford?

A. 47, 48 miles.

Q. And there are seven other cheese factories in that 60 mile radius?

D. Tonak - Cross by Mr. Beshore

A. Yeah, approximate. I'll take that back. We need to add one. There's eight because there's Stockton Cheese at Stockton, Illinois.

Q. That's the former Kraft facility?

A. That's the former Kraft facility.

Q. Who operates that now?

A. Brewster Cheese out of Brewster, Ohio.

Q. If you take those eight, nine cheese plants --

A. And that's a rough approximation just off the top. It may be 10 or it may be 7.

Q. Let's say there are at least nine. Is that fair?

A. Okay.

Q. Take those nine cheese plants. How many producers supply them, those plants?

A. I have no idea.

Q. Well, you would have some idea?

A. Well, the Grande plant is supplied by about, I think, eight producers principally and a few others on occasion.

Q. Let me rephrase my question. How

D. Tonak - Cross by Mr. Beshore

many -- the production, how many farms do those plants, you know, process on an average month? I don't mean how many direct affiliated producers they have. You know, what's the capacity of those plants roughly in terms of numbers of producers that they --

A. I really do not have any idea, and I would hate to try to estimate.

Q. Well, the Grande is a big plant, right?

A. Yes.

Q. You said that. So I mean give us -- you can certainly provide from your many years of experience and your knowledge in the market and your expertise, you can provide an estimate of, you know, how about volume per day?

A. Well, you know, maybe it's 500 producers, give or take a couple hundred producers.

Q. How about Stockton?

A. Now, that's the total aggregate of all those plants, Stockton, Grande, the whole group, maybe 500 producers, give or take a couple hundred.

D. Tonak - Cross by Mr. Beshore

Q. Okay. Are those plants within that area the primary plants where you divert milk to when it's surplused?

A. They are our first choice to divert milk to. At times, and we probably are entering one of those times, later this month our experience has been that we have had to move milk as much as 250 to 300 miles to find a home for it.

Q. If you went out, you know, 100 miles from Muller-Pinehurst, how many more cheese plants would you be taking into, you know, your area?

A. You may double the initial number.

Q. Now, you have given variances from the meeting in terms of balances Muller-Pinehurst, if I understood your data correctly. Can you tell us what is the means so we have some idea of how much, you know, those variances mean?

A. I would really like to tell you. Since we do not own that plant solely by ourselves, I really can't, but I would suggest that it is not a large plant, that there's

D. Tonak - Cross by Mr. Beshore

approximately, I believe, about 30 distributing plants pooled on Order 30, and that if you give me a minute, there is somewhere between 300 and 400 million pounds of Class I milk pooled on Order 30 every month, and from there, you would be able to derive a relative approximation --

Q. Of an average size?

A. Of an average size, and we would characterize ourselves as not a large plant, but being probably close to the average size. Is that sufficient for your purposes?

Q. Well, if you say they are 300 million of sales 400 million of sales in 30 plants, you are saying the average size is what, 12 to 15 million?

A. 12, 13 million, something like that.

Q. And you are in the range of average?

A. I think that's a fair characterization.

Q. Okay. At a peak count, do all your producers supply Muller-Pinehurst, and does it take all the production of your members?

A. No, not all of our producers are used to supply Muller-Pinehurst. We have a

D. Tonak - Cross by Mr. Beshore

commitment to supply another fluid plant on an ongoing basis. We have some incidental, I'll call them, supply commitments. As an example, we have a commitment to supply Class II ice cream mix manufacturer. During this time of the year they take very little milk, but during the summer they take a fair amount, and it helps us do a bit of balancing, and to the extent that we supply some of these other balancing-type commitments, it's been probably two years since all of our producers have supplied Muller-Pinehurst.

Q. Okay. Now, you have challenged the constituents to which Dr. Cryan testified, National Milk, by noting that you are a member of Lakeshore group and Manitowoc members and don't share the same jargon --

A. Yes. Mid-West, Manitowoc and --

Q. Right. Going so far as to characterize National Milk is only speaking for a sliver of Diary farmers. What is your definition of sliver, Dennis?

A. That might have been a stretch.

Q. Do you think so?

D. Tonak - Cross by Mr. Beshore

A. Well, you know, sometimes you can get a pretty big sliver. Sometimes you get a little sliver. This would probably be a little larger sliver. When you pull out those National Milk members who are opposed, when you pull out the milk volumes in California that are a significant portion, as I understand it, of the National Milk membership, make some of these other adjustments, the volumes are not quite -- that would be supportive are not quite what Dr. Cryan suggested.

We also understand that in any organization, cooperative there may be a number of different view points presented for consideration and that the majority is the prevailing viewpoint. At the same time, we want to make clear that not all National Milk members support National Milk's position on this issue.

Q. Now, your testimony on page 3 suggests that, quote, "most of Pennsylvania", close quote, is outside of defined federal order areas, and I assume you intend that statement to have some significance to your

D. Tonak - Cross by Mr. Beshore

comments here?

A. Well, it's just that there's a large area, geographic area when you look at the map of the federal order areas.

Q. But I assume --

A. And I have no way of knowing what milk from which areas the cooperatives may or may not be pooling.

Q. So you didn't investigate what one percentage of producers in Pennsylvania are pooled in the federal order system?

A. I did not have a lot of time to work on a lot of things. I apologize that this is kind of a quick broad-rush, but with the short notice, it didn't give a lot of time to prepare.

Q. In all fairness, Dennis, I mean you have complained about the short notice, but you had enough time to prepare the long statement we have seen here short of Dr. Cryan's, did you not?

A. Well, that was done at the kitchen table at night after the grandkids and everybody had gone to bed, you know.

D. Tonak - Cross by Mr. Beshore

Q. So that's what accounts for your comments about Pennsylvania, the geographic area having some significance to National Milk not --

A. The only significance is when you look at a map of federal order areas, there's a large part of Pennsylvania that is not covered by a federal order map.

Q. It would be more important for these proceedings, as far as Pennsylvania is concerned, to know whether the producers in Pennsylvania are pooled on federal milk order pools, wouldn't it?

A. I would assume so.

Q. Do you happen to know if there are any plants in that area that aren't fully or partially regulated?

A. No, I do not.

Q. How about New York, what are your -- what's the significance of your statement that some of New York is outside of the defined federal order areas?

A. Same as for Pennsylvania.

Q. So you wouldn't know then that

essentially all producers in New York are either pooled or have their milk prices directly linked to federal order prices?

A. I do not know that they are pooled, and just because you link a price to a federal order price doesn't mean that the federal order regulates that pricing.

Q. It would have some effect though?

A. This proceeding here and its impact on milk production, increased milk production, increased milk to cheese, lower cheese prices as an example will have an effect on California milk prices. We're national, we're a national milk market.

Q. So California producers and National Milk maybe had something to say about this?

A. Well, from that standpoint. I'm just saying that if you view who is affected by the regulated impact in their blend price, it's only the federal order producers. To the extent that there's impact on cheese prices, butter prices, powder prices, to the extent that there's added competition for cream coming out of California back to an ice cream plant in

D. Tonak - Cross by Mr. Beshore

Illinois, that's competitive factors, and competitive factors will include pricing and national influence.

Q. I'm interested in that. Let's talk about that transaction just a little. You understand from Dr. Cryan's testimony that cream in California, Class II, is priced significantly higher than it is in the federal order system now, correct?

A. Cream still moves when there is a need, and if the premiums are correct, you can make things happen. If we postulate that a current existing condition will continue to exist, we are going to be surprised. Class IV has been significantly higher than Class III prices at various times over the last five to six years, though in the federal order reform process, that was not particularly identified as being probable.

There was a change in the protein price formula in about 2002 because the cheese price -- butter price had changed significantly from the basis and relationships that were used in establishing the formula initially.

D. Tonak - Cross by Mr. Beshore

Q. Okay. And the point of that is what?

A. The point of it is so it's that way now. That doesn't mean it will stay that way in the future.

Q. Okay. I want to understand your thoughts on regional equity a little bit. You welcome efforts to approve producer income but prefer solutions that treat all regions equitable. Did Mid-West Dairymen support the MILC program?

A. Yes.

Q. That doesn't treat all regions the same, does it?

A. It treats all regions the same to the extent that they have similar size producers. MILC, in our view, is a regional neutral. It is not size neutral, and to the extent that one region of the country has a larger average size producer, you can infer that it's not treating all regions equally, but, in fact, it discriminates, if you want to use that word, between large and small producers in that a small producer could

D. Tonak - Cross by Mr. Beshore

receive MILC payments every month if they are available and a large producer may not.

Q. But what I want to understand is in your view, it's equitable, your word, it's equitable to have MILC payments applied to 76 percent, to use Dr. Gould's calculation, and I assume it's right, 76 percent of the milk in Wisconsin, but only, let's say -- I don't know that this is right, 30 percent of milk in New Mexico that's equitable?

A. Everyone receives an MILC payment on the same volume of milk.

Q. And if it only covers --

A. If you happen to be a smaller producer, so you do not hit the volume cap, then you receive a payment on 100 percent of your milk. If you are a large producer in the volume cap, you do not receive a payment on 100 percent of your milk, but you receive as a producer, every producer receives full payment up to that volume cap, and that is equitable.

Q. We all understand how it works. I want to know how it's equitable. So let's consider then that it's equitable if Wisconsin

D. Tonak - Cross by Mr. Beshore

has a 76 percent utilization of MILC farms, but another area only has a 30 percent utilization of MILC farms. As long as the utilization is paid out on the same basis, that's equitable, correct?

A. As long as everybody is treated the same on a volume basis.

Q. Now, however, I take it you object to the National Milk proposal which would apply an even dollar amount, 77 cents to every hundredweight of milk for Class I purposes regardless of where it's manufactured? That's how it worked, right? Same rate everywhere for the same hundredweight of milk, correct?

A. That would be correct based on my understanding.

Q. Right. But you object to the fact that some areas would have more of their transactions qualifying than the upper midwest, correct?

A. What I object to really is the delinking or decoupling of the Class I and II price from the Class III and IV price.

Q. Okay. Let's talk about that.

D. Tonak - Cross by Mr. Beshore

A. If there had -- if this proposal had been put forth in a manner of increasing all Class I differentials, 77 cents, I may moderate my opposition, and when I say I may, that's on a personal basis, not necessarily speaking for Mid-West or Manitowoc or Milwaukee.

Q. Well --

A. But our problem is -- or our concern is, number one, the decoupling; number two, applying it to the mover, applying an increase to a over when there is absolutely no justification for it instead of just saying, here is the deal, let's cut to the chase, all we want to do is give more money to dairy farmers, all the other stuff is just malarky and we're going to just increase the Class I differential 77 cents.

Q. You would support that?

A. I didn't say I would support it, but it would be more acceptable.

Q. That would be more acceptable than linking it to the costs embedded in supplying Class I market identified in the federal order reform decisions in 1998 and 2000 as Dr. Cryan

D. Tonak - Cross by Mr. Beshore

did?

A. As I testified, all of the impact of the 77 cent increase is is to increase blend prices, if you will. It does not actually go to addressing the costs that Dr. Cryan postulated to.

Q. Dennis, the 77 cents on that mover is going to have the exact same effect on the blend prices as your 77 cents price on all differentials?

A. It's the way you are doing it.

Q. Not the end result, just the way you get there?

A. In my view, it's the way you are doing it.

Q. Will you support the end result?

A. No, but --

Q. So it's not just the way we're doing it, it's the end result?

A. Well, the end result is a concern because we're going to increase milk production when there is no necessity to increase national milk production, and we are going to artificially increase the Class I price which

D. Tonak - Cross by Mr. Beshore

is going to have a negative impact on consumption, and that ends up to being a losing approach.

Q. But uniformly increasing the Class I differential might work?

A. If you increased the Class I differential, increased transportation credits, assembly credits and put in balancing credits across all orders, I think there could be some reason to really look at it.

Q. We might be able to talk. Let's talk about what you have called the delinking or decoupling. You had some comments about that on page 7. Maybe page 6. But page 7 anyway. Looking at Dr. Cryan's proposals 1 through 5, those formulas, they continue to utilize the commodity prices of cheese, nonfat dry milk and butter as the base for the prices, do they not?

A. That would be correct.

Q. So I guess I'm not -- I don't fully comprehend from your comments what the perceived issue is. They are linked to commodity prices. That's what -- you know,

D. Tonak - Cross by Mr. Beshore

that's what the system that you have, you know, studiously walked us through and your testimony here has done for, you know, a number of years. They are still linked. Where is the disconnect?

A. They are linked to commodity prices. They are not linked to the Class III or IV price, and that is a big, big disconnect. Let's say we hit an extreme depression. Fuel prices go down. Labor costs go down. We go to a hearing and reduce make allowances that will increase the Class III price in relationship to the Class I price. At that point in time, I guess you are going to want to come back to a hearing to change the Class I and II formulas.

Q. Is that the concern, what might happen if make allowances get reduced? Is that scenario a concern?

A. That's one concern.

Q. What other concerns do you have?

A. The other concern is if they don't get reduced.

Q. And then what's the concern?

A. The other concern is that we have

D. Tonak - Cross by Mr. Beshore

gone through formulaic changes in the Class III and IV price a couple of times, adjusting how the formulas operate, and it just seems to us that it would be much cleaner to continue to tie the Class I and II price to the Class III and IV price with a fixed differential.

Q. Isn't it correct, Dennis, that what the formula as proposed by National Milk and as testified to by Dr. Cryan is to give the secretary the clear opportunity and need to evaluate that identity at the time, whereas, now it's an automatic impact regardless, but now you would have to specifically look at it and make a decision to keep them the same or to move them in another way? Isn't that what's --

A. I don't see any reason to not have an automatic impact when you change the Class III and IV formulas.

Q. But are you afraid that the spread is going to increase or decrease?

A. The best change is no change. I'm not necessarily concerned that it will increase or decrease any more than what the proposal calls for it to do. I do not care for

D. Tonak - Cross by Mr. Beshore

decoupling. I think the other concern is that once you decouple, it becomes much easier to try to institute Class I and Class II price floors at times of relatively low milk prices, and it puts us on a very slippery slope of completely separating the reality of the marketplace as revealed in Class III and IV prices and what the Class I and II prices are established as.

Q. With respect to just the Grade A and B, you have put a lot of comment to what the cost of converting Grade A to Grade B might be. Did you understand that that was -- that there was some quantification of the cost of converting that we were talking about in Proposals 1 through 5?

A. If the --

Q. Just yes or no. Did you understand the cost of converting whether, you know, attracting people to convert was some underlying premise of the proposals? I assume you must have or you wouldn't have made the comments you did.

A. My understanding was that there was

D. Tonak - Cross by Mr. Beshore

a move to increase Grade A blend prices to attract the production of more Grade A milk that would be available for fluid.

Q. But if --

A. And the manufacturing pool of milk is one of the segments that's in production right now that could be attracted to Grade A fluid use.

Q. So if, however, the contention was to reflect the cost of maintaining that Grade A production and supply relationship to I and II, then your thoughts about attracting new milk and converting wouldn't be perfect, would you agree with that?

A. I wouldn't necessarily say that.

Q. We're not talking about converting, what the pertinence is.

A. It's an available supply that can readily convert, at least in some cases. We identified some of the costs.

Q. And that milk that's already being produced and manufactured, are you putting that into the equation of driving down the -- adding to manufactured volumes?

D. Tonak - Cross by Mr. Rosenbaum

A. Not directly, no,

MR. BESHORE: Thanks.

JUDGE PALMER: Any other questions.

CROSS-EXAMINATION

BY MR. ROSENBAUM:

Q. On the question of Grade A versus Grade B, have you looked at Dr. Cryan's testimony?

A. Not since the other day.

Q. But you have seen it?

A. Yes.

Q. And do you understand his testimony would have been that one of the factors he thinks goes into the determination of the size of the Class I differential, or in his case, the increase in the Class I mover, the same thing, one of the indicia is the cost of being a Grade A farm versus a Grade B farm?

A. That would be my understanding, yes.

Q. And you have provided direct testimony suggesting using real life examples that, in fact, that cost may be on the order of a nickel per hundredweight, correct?

A. That would be correct.

Q. In the 1998 discussion of that issue, USDA, based on data they didn't reveal but presumably had some basis for at the time, estimated that as being 40 cents per hundredweight. Are you aware of that?

A. Yes. I saw that number. I somewhat wondered where it came from.

Q. In any event, your data would indicate that, in fact, updating that cost to reflect current realities would, in fact, lead to a decrease in the Class I differentials if, in fact, this is the factor that's going to be seized upon or one of the factors seized upon for making that determination?

A. That would be correct based on what we have seen so far.

Q. And, in fact, you have presented direct testimony indicating that as of today in Wisconsin, which is one of the states in which there is still Grade B milk, correct?

A. Yes.

Q. The standard for being a Grade A

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firm versus a Grade B farm has narrowed, correct?

A. That's correct.

Q. And you pointed, for example, to the fact that once upon a time, it could be a Grade B farm with a somatic sale count of significantly higher than the Grade A standard?

A. That's correct.

Q. That is no longer the case?

A. That's correct.

Q. And you have identified, for example, the continuing obligations of being a Grade A and Grade B farm as being twofold in Wisconsin; one, that you on a Grade A farm cool your milk to 35 degrees rather than 40 degrees?

A. Actually 45 degrees instead of 50 degrees.

Q. I stand corrected. Then the other is the bacterial count?

A. That's it, correct.

Q. That's it, correct?

A. That is the differences in the regulation.

Q. So if USDA would decide they wanted

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to apply these same standards that are being pushed by the proponents, your testimony would indicate that we ought to reduce the Class I differential, the Class I mover by 35 cents? That's where their logic, the proponents logic would lead, correct?

A. That's the way the math works. That's why we feel the best change is no change.

Q. Now, you were asked a question by Mr. Beshore, and perhaps, I didn't hear it right, but I thought I heard it right. His suggesting that Dr. Cryan testified that the price of cream in California is higher than the price of cream in the national order than in the rest of the country. Do you remember Dr. Cryan making any testimony to that effect? I don't see it in Exhibit 5.

A. I do not recall it on direct. There may have been in his direct statement, and I may have missed something in his question and answer.

MR. ROSENBAUM: We'll let the record read as is. I don't recall that testimony under any circumstances. I think that's all I have.

JUDGE PALMER: Any other questions? Mr. Tosi.

CROSS-EXAMINATION

BY MR. TOSI:

Q. Excuse me, Mr. Tonak. I had to shuffle some papers. I lost my place. Could you please expand a little bit on what you see is the difference between when something is equitable versus when something is equal?

A. I would sure like to. Equal would apply in this case the, let's call it, 77 cent increase, and that would treat all Class I handlers equally. Everybody would pay 77 cents more. It would not necessarily treat all the recipients of the equal application of that 77 cents equitably. The 77 cents would flow through various pools ending in various net results depending on area, region irregardless of the size.

The way to treat everyone both equally and equitably would be to take the 77

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cents increase and set it aside on an overall basis amongst all the pool participants no matter what region of the country and share it on a pro rata basis. I'm not sure if that answers.

Q. I think I followed you. I appreciate your answer, sir. I took from your testimony that when we engage in the market-wide pooling of milk, that those who actually supply -- those producers who actually supplied the Class I market, that their costs are not exactly recovered vis-a-vis producers whose milk ends up not going to Class I. Is that what you are suggesting?

A. Based on the regulated price and distribution of that regulated price through the pool, that would be correct.

Q. If that's the case then, are you opposed to market-wide pooling?

A. No.

Q. Can you just basically explain why you are not opposed to market-wide pooling.

A. We are not opposed to market-wide pooling because there is certain benefits in

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maintaining orderly marketing conditions that accrue to all producers by overall -- pooling all proceeds amongst all eligible producers or sharing proceeds amongst all the eligible producers. We do feel, however, that the Class I price difference between the announced Class I price and the Class III price does not go to cover the cost of supplying the Class I market. It goes to attracting milk to the pool.

Once milk is associated with the pool, the various shipping requirements, as an example, in the upper midwest order, 10 percent help move milk to the pool. So the more milk in the pool at the 10 percent shipping requirement, the more milk there's available for fluid use, and market-wide pooling helps to share those -- share the pool proceeds across the entire marketplace.

If we can go out and change the shipping requirement in the upper midwest order to 60 percent and knock a bunch of the milk off the pool, we would look at it, and that's why I think there's an importance in having dairy programs protect us from ourselves, you know,

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help me so that I don't kill again.

Q. Well, I mean if it turns out that a very, very small percentage of dairy farmers in the upper midwest are the ones that are actually supplying the Class I market under the logic that I think you are presenting here, would say, you know, perhaps, it should be 60 percent?

A. What happens --

Q. Because that would be equitable because it's the guys that are actually performing that get the reward?

A. What will happen then is a tendency for those that do not have access to the pool to search for another pool to affiliate with, and this has somewhat happened with the initiation of the federal order reform. We saw milk shifting from traditional markets into higher utilization markets that were relatively loose pooling standards in the upper midwest. We had two hearings on pooling standards. A lot of the other orders went through the same cycle in 2002, 2004 as they tried to keep more distant areas from encroaching on the pool

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proceeds without serving the fluid needs.

Q. You couldn't imagine for a moment the producers, say, in northern Minnesota, way out in the country, not close to a Class I plant, their milk gets pooled on the upper midwest order because the handler that did it or the producers themselves found a way to get it pooled, and then there are producers located elsewhere that are actually shipping milk in the fluid market.

I think what you are saying here, and correct me if I'm wrong, that because of market-wide pooling, that there's an inequity here, and the burden of those who are supplying the Class I market versus those who are getting rewards of supplying the Class I market?

A. That would be my view, yes, that there is an inequity.

Q. If the economic research service came out and said that the average cost of production in Wisconsin, for example, this $20 per hundredweight, okay, and somebody else came in and said, well, I know a guy that produces milk for less, or I know a guy that produces

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milk that costs him more, with respect to then whose weight, where should we look at putting weight on which source to find to be more reasonable to rely upon in making the decision?

A. The marketplace is a cruel task master, and in general, we need to look to those with the lowest cost. As much as I find that distasteful, that is how we need to approach things. It is not the purpose of the federal order program, in our view, to assure that producers' production costs are recovered. It's for the purpose to make sure there is an adequate supply of milk for fluid use and then to maintain as much order as possible through a regulated environment.

Q. Wouldn't orderly marketing conditions necessarily need to happen first so that there is an orderly exchange of commodity that first goes to the Class I market and, therefore, achieves that objective?

A. I feel it's somewhat of a symbiotic relationship or a chicken and egg situation. I don't think you can say there's one that takes preeminence or predominance over the other.

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Q. With respect to the other cost information that's been offered by the proponents, do you challenge the validity of the cost information that's been provided with respect to additional cost with regard to transportation, competitive factors and the -- I believe I understand pretty clearly what you are saying here about the Grade A maintenance or conversion from B to A component. I'm talking now about the other two major components.

A. I do not necessarily challenge the numbers. Transportation costs have gone up. Other costs have gone up. By applying those increases and gearing it to the Class I differential or the -- an increase in the Class I mover, excuse me, the cost factors may be right, but the dollars that they would generate under their proposal will not necessarily go directly back to those who are incurring those increased costs. It gets shared with the market-wide pool.

Q. Is your objection to the proposal, the National proposal, does it have more to do

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with what you think the outcome is going to be to the producers that you represent or the validity of the evidence that speaks to higher costs that producers incur in serving the Class I market?

A. It's do you recover those costs through a change in the -- to the Class I mover or do you recover it in a market responsive fashion through over-order premiums. Our concern is very directly the decoupling, the direct decoupling that these formulas would achieve, and the incentive to produce even more milk through higher blend prices when there is no proven need for additional milk to meet Class I needs.

Q. I'm confused as to your conclusion or your observation here that the National Milk proposal is a complete decoupling from how Class I and II prices are from III and IV. Would you please speak a little bit more to that. I'm at a loss to see where something has been decoupled here.

A. There is no direct tie under the National Milk proposal to the Class III price

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or the Class IV price. That's what we view as decoupling. There obviously is a reliance on the same butter, cheese and other product prices, but it does not tie directly to the Class III and IV price. So as formulas change, as conditions change, you end up with a change in one set of pricing, regulated pricing without a change being achieved in the other set of formulas or regulated pricing.

In other words, you change the make allowance on Class III and IV, it does not impact Class I and II. Cheese goes up. Cheese goes up down. Powder goes up. Powder goes down. All prices move, but there is not a direct tie to what that regulated Class III price is or that regulated Class IV price is. It's a secondary tie through the product prices.

Q. What would make it a direct tie?

A. A direct tie, as we have now, the differential.

Q. One moment, please. With regard to your Exhibit A, can we refer to that for a moment?

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A. Okay.

Q. The major point that you are making with this exhibit has to do with drawing a conclusion that independent of what the amount of milk is that's pooled on federal orders, Class I remains roughly the same as compared to the amount of milk produced?

A. That is correct.

Q. Would you agree that one of the contributing factors for why the amount of milk that was producer receipts in 2003, 2004, 2005 had to do with implementation of new rules that refined pooling standards in the order?

A. I don't think it was as much the rules that refined pooling standards as it is -- though that may have been a minor rule, but I think most of the milk that was eligible to be pooled was pooled -- it may have been pooled on a different order than it had been earlier. The 2003, 2004 were heavily impacted by Class I, Class III pricing versions of depooling.

Additionally, in 2004 both the Class I price and the -- or the Class I utilization

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and the producer receipts were impacted by the termination of the western order in April of 2004. So those are the two major factors, depooling and termination of the western order.

Q. Thank you. But the major point you are making here is the constancy, if you will --

A. That's correct.

Q. -- in the volume that goes with Class I?

A. That is correct.

MR. TOSI: That's all I have. Thank you.

CROSS-EXAMINATION

BY MR. ROSENBAUM:

Q. I want to follow up on this question of depooling. Are you aware of the fact that last week I think --

THE FLOOR: Decoupling.

Q. I'm sorry. Decoupling. Are you aware of the fact that last week USDA had a workshop to address possible additional changes in the Class III and IV formulas?

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A. I know they had a workshop.

Q. That workshop was with respect to various proposals that USDA itself solicited for changes in the Class III and IV formulas, correct?

A. That is my understanding.

Q. And that workshop was called in anticipation of there being a hearing in the near future to address at least some of those proposals, correct?

A. That would be my assumption. I did not attend the workshop.

Q. Okay. Now, let's assume that those hearings are held in January or February of next year, and let's assume that they do, in fact, result in changes to the Class III or IV formulas or both; all right?

A. Okay.

Q. Now, if National Milk's proposal is adopted, the one we're here today on, then those changes do not get passed through to the Class I and II prices, correct?

A. That would be my understanding of National Milk's proposal, yes.

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Q. Because under their proposal, Class I is no longer Class III -- the higher Class III or IV plus Class I differential, Class I has its own self-contained formula, correct?

A. That is correct.

Q. And similarly, Class II would no longer be Class IV plus the Class II differential because Class II would have it's own formula?

A. That would be correct.

Q. So to the extent that Class III and IV are changed as a result of these upcoming proposed hearings due to adjustments and the yield factors or the re-evaluation of the value of whey butter, which I will represent to you are all issues that have been raised or discussed at the meeting last week, none of those would cause any change in the Class I or II prices based upon the proposal before us today if adopted, correct?

A. That would be correct.

Q. And are all these, in fact, examples of ways in which the Class I and II prices would be decoupled from Class III and IV

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prices?

A. That is correct.

Q. And Mr. Beshore's questions and hypothetical examples of things that might happen in the distant future are really not nearly as relevant as, in fact, what USDA's current contemplated hearings in the near future to consider changes to the Class III and IV formulas; is that right?

A. I think so.

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

JUDGE PALMER: Any other questions? Mr. Tosi.

CROSS-EXAMINATION

BY MR. TOSI:

Q. I'm sorry, Dennis. I lost my question here in the shuffle of paper. I want you to imagine a hypothetical scenario. If it comes to pass that the make allowance for Class IV products is believed to be wrong needs to be raised, if we had a hearing just on that, on those costs, how would that sit with you with

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respect to re-examining what the costs would be with respect to the make allowance factors there?

A. If I understand your question, the question is if you held a hearing just on Class IV make allowance and not on Class III make allowance, how would that sit with us? Is that --

Q. Would you believe, for example, that the prices now that we're setting, that they are reasonable and that it's going to help promote orderly marketing?

A. That would be my general view. I'm going to go -- step aside for a minute. I don't like formula-based pricing. It's messy. It does not self-adjust well, and I much prefer the old basic formula price, MW price, Class III price prior to order reform. We don't have that. We have a different system in place, and, whereas, the old Class III price self-adjusted for changes in manufacturing costs, this new formula doesn't, and so we will -- as long as we have this type of formula-based pricing, we will go through periods where we

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get very contentious in what is the right adjustment and what does it do to produce income, but it still has to be done in order to maintain orderly marketing.

Q. If it results or -- excuse me. If the Department determines that the new formula that's being offered in III and IV without the proposed 77 cent adjustment results in the same values as do the current formulas, how is adjusting those values by an additional 77 cents to arrive at a Class I price different than a Class III, Class IV formula arrives at a value to which you have a higher -- a 77 cent higher differential? What is the effective difference there?

A. If nothing changes, if you determine that there needs to be a higher Class I price compared to the Class III and IV price and everything holds stable, I don't know that there is a great difference.

Our concern is as these various formulas change, that the Class I and Class II price change in direct relationship to the Class III and IV price, not just through some

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formula, and if there's sufficient evidence to show that we need a 77 cent increase in the Class I price through the mover or through the differential, it would be much better to do it on the differential than to come up with a different set of formulas and do it as a Class I mover and hold the differentials the same.

Q. So to the extent that the Class I price now is determined by the higher of the advanced Class III or IV formula value plus a differential, you don't see that as a formula in the same way that you are observing the National Milk proposal?

A. That would be correct. The formulas in the class in determining the mover through the class -- the same formula that determines the Class III and IV price. You determine the Class III and IV price or the advanced price through the same formula, add a differential to it. That's the Class I price. Under the National Milk proposal, you have got some formulas determining Class III and IV price. You have got other formulas that are distinct separate and different determining the Class I

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and II price.

Q. Do you see a benefit or a wisdom, if you will, to the extent that our minimum class prices are in some way based on cost information, whether it be the cost that manufacturers incur or additional costs that producers incur for specific purposes in Class I, that if we're going to have a proper relationship among all the classes, that it would be more appropriate, perhaps, to -- before it would change any class price, to look at qualities, cost factors at the same time?

A. If you are asking me would I feel we should look at Class I, Class II, Class III, Class IV price across all orders, the entirety of the formulas and how they are established including the differentials?

Q. No, sir. I was -- I'm sorry. I mean --

A. Maybe I read --

Q. I'm just trying to focus in on the cost components of how those prices are determined?

A. If there's going to be anything done

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on a cost-component basis, I feel that needs to be done, number one, in addressing Class III or IV prices, and number two, to the extent you did on Class I prices, it has to be done in conjunction with assembly credits, transportation credits and balancing credits.

Q. Hypothetical situation. Let's assume that your Class I differential is $2.00 and your Class I utilization is 15 percent. You're in another market where Class I utilization is 50 percent. Okay. And the same differential. The fact that the math would work out to say that the blend price in the market that has a 50 percent Class I differential is higher than, say, in your market, do you see that as being equitable, an equitable outcome?

A. There is a possibility of a certain amount of that being an equitable outcome. It is made more difficult by not knowing what leads to those 20 percent and 50 percent utilization figures. Is the 50 percent because one cooperative has great market power and is excluding milk from that 50 percent utilization

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order, enforcing it to the 20 percent utilization order because of easier pooling standards, the milk is going to pool somewhere, and it's easier to pool in the lower utilization order? If that's the case, it would not necessarily be equitable. If the marketplace was demanding that type of relationship, then there would be -- it would be more equitable.

Q. So in the case where we would have this big powerful cooperative, to the extent they would want market-wide service payments, balancing credits, would that be proper? I mean they are the ones that are actually supplying the market?

A. I think that would be a proper approach.

(Discussion held off the record.)

JUDGE PALMER: I'm going to shut it down in a few minutes. Apparently you'll have to come back tomorrow.

MR. VETNE: Mr. Tonak, you're going out tonight, right?

JUDGE PALMER: Pardon?

MR. VETNE: I thought Mr. Tonak was going out tonight.

JUDGE PALMER: Well, that may be, but I don't know what we're doing. These questions need to be asked, and I guess he's going to have to come back tomorrow. I've got to get the reporter out of here. She has her schedule, too. Do you have much more, Mr. Tosi?

MR. TOSI: No, sir, Your Honor. I'm sorry if I'm --

JUDGE PALMER: No. Absolutely not. You have the right to develop the record, but I think we're going to -- can you just --

MR. TOSI: I'm satisfied with the questions I have asked.

JUDGE PALMER: Did you finish?

THE WITNESS: Yes.

MR. TOSI: I have no further questions, Your Honor.

JUDGE PALMER: We'll adjourn until tomorrow.

(At this juncture, the hearing was adjourned at 5:34 p.m.)

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/Tricia M. Clegg
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Tricia M. Clegg